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Supreme Court of the United States,

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The Fidelity and Deposit Company of Maryland,

Petitioner,

VERSUS

R. H. Courtney, Receiver of the German National Bank of Louisville,

Respondent.

On Writ of Certiorari to the Circuit Court of Appeals for the Sixth Circuit.

BRIEF FOR PETITIONER.

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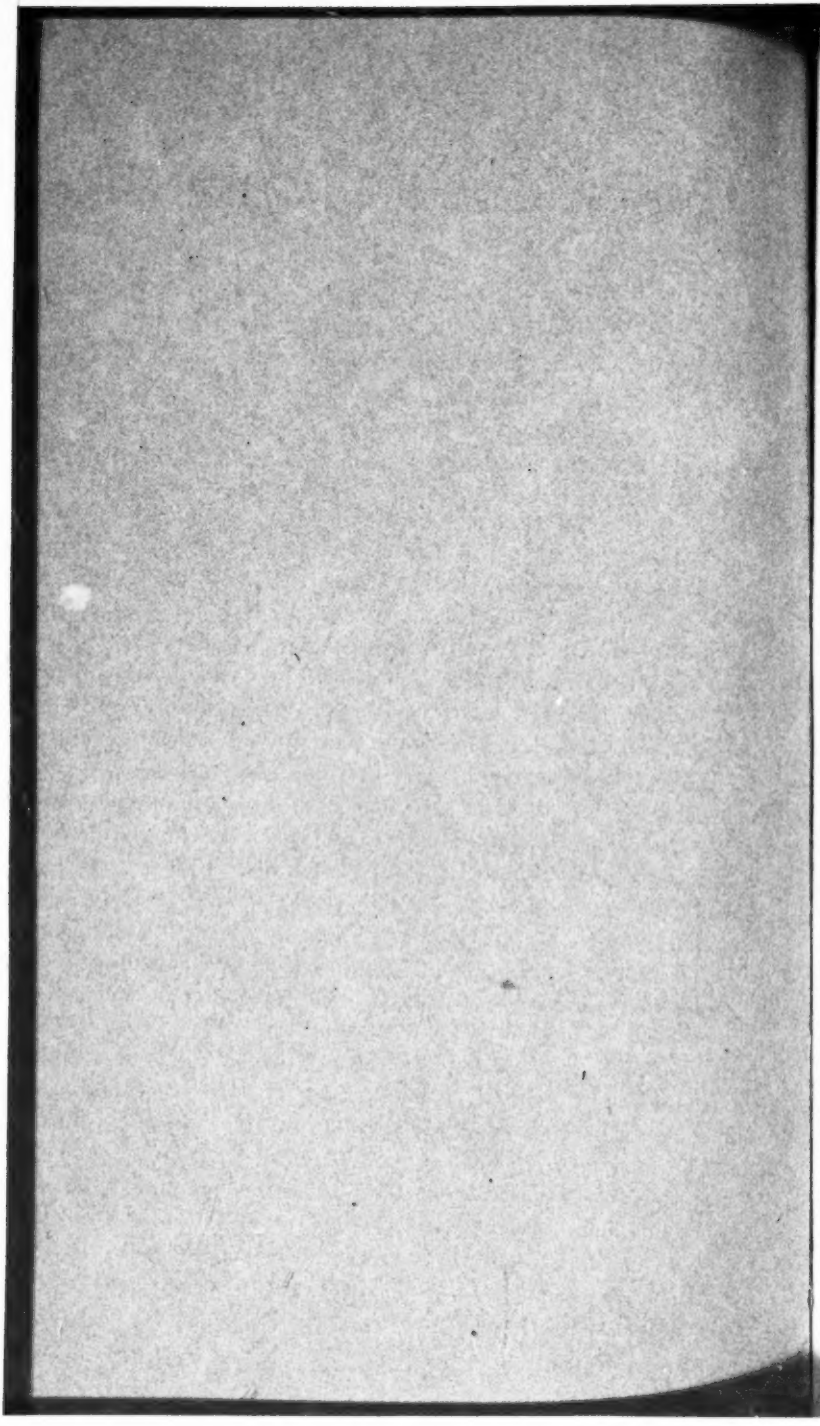

Supreme Court of the United States.

THE FIDELITY & DEPOSIT COMPANY OF MARYLAND, - - - - - - - - *Petitioner,*

VERSUS

R. H. COURTNEY, RECEIVER OF THE GERMAN NATIONAL BANK, - - - *Respondent.*

Brief for Petitioner.

STATEMENT.

The respondent, on February 5, 1898, filed in the United States Circuit Court for the District of Kentucky (Rec. 1) a petition against the Fidelity & Deposit Company of Maryland on a bond for $10,000.00 given by the said Company to the German National Bank, of Louisville, Kentucky, for the fidelity of J. M. McKnight, first as Vice-President and then as President of said Bank. The Fidelity & Deposit Company answered, and there was a trial by jury and a verdict and judgment rendered for the Receiver of said Bank for said sum against the petitioner. A writ of error was sued out to the United States Circuit Court of Appeals for the Sixth Circuit to correct the errors committed on the trial of said action in the admission and rejection of testimony and in the instructions of the Court. Thereafter, on July 13, 1900, said Circuit Court of Appeals affirmed said judgment of the United States Circuit Court for the District of Kentucky. On October 22, 1900, the plaintiff in error filed a petition in the Supreme Court of the United States for a writ of certiorari to the said Circuit Court of Appeals, and said petition was granted; and said writ and return were filed November 5, 1900.

A short time prior to June 1, 1894, J. M. McKnight was elected Vice-President of the German National Bank. At that time Adolph Reutlinger was President and a director of said Bank, and his son, Rudolph Reutlinger, was the Cashier. On June 1, 1894, J. M. McKnight, as Vice-President, gave to the

German National Bank of Louisville a bond in the sum of $10,000.00, with the Fidelity & Deposit Company of Maryland as its surety (Copy bond, R. 29). In January, 1895, McKnight became President and Adolph Reutlinger became Vice-President. McKnight remained President until the Bank was closed January 18, 1897. Adolph Reutlinger remained Vice-President until September 5, 1896, at which time he resigned. On June 1, 1895, McKnight's bond was renewed for a year (R. 32). On June 1, 1896, said bond was renewed for another year.

On January 18, 1897, the German National Bank was closed by the Controller of the Currency of the United States, and on January 22, 1897, R. H. Courtney, the plaintiff below, was appointed receiver of said Bank, and he brought this action on February 5, 1898, to recover of the surety the full amount of said bond for the various defaults and embezzlements of McKnight, which, it was then claimed, amounted to $18,742.74. Some of the items set up in the petition were abandoned by the Receiver at the trial, and no proof was offered as to them.

The Fidelity & Deposit Company in its original Answer denied knowledge or information sufficient to form a belief of all said alleged defaults and embezzlements of said McKnight. (R. 8.) Subsequently, with leave of the Court, the Fidelity & Deposit Company filed an Amended Answer (R. 11) in which the Company set up all the important provisions of the bond, and especially the following parts:

(1) "That the German National Bank shall [*a*] immediately give the Company notice in writing of the discovery of any default or loss hereunder, and [*b*] shall file with the Company his or their claim hereunder, with full particulars thereof as soon as practicable thereafter, and [*c*] no claim which shall not be so filed by the employer with the Company within six months after the expiration or cancellation of this bond, or within six months after the employe shall have ceased to be in the employer's service, shall be payable hereunder."

(2) "That upon notification to the Fidelity and Deposit Company of any loss hereunder, the said Fidelity and Deposit Company's liability shall thereupon terminate as regards any subsequent act of the employe, J. M. McKnight."

(3) "That the employer, the German National Bank, shall observe due and customary supervision over the employe, J. M. McKnight, for the prevention of default, and, if the employer,

the German National Bank, shall at any time during the currency of this bond condone any act or default on the part of the employe, McKnight, which shall give the employer, the German National Bank, the right to claim thereunder, and shall continue the employe McKnight, in its services without written notification to the Fidelity & Deposit Company, the said Fidelity & Deposit Company shall not be responsible hereunder for any default of the employe, McKnight, which may occur subsequent to such act or default so condoned."

(4) "That there shall be a complete inspection of the accounts and books of employe, McKnight, on behalf of the employer, the German National Bank, at least once in every twelve months from the date of this bond (June 1, 1894), such inspection to include examination of all cash or securities of which the employe, McKnight, shall have custody or charge.

(5) "That the employer shall at once notify the Company on becoming aware of the employe being engaged in speculation or gambling, or indulging in any disreputable or unlawful habits or pursuits."

The said Amended Answer set up that neither the German National Bank nor the Receiver thereof ever gave to the said Fidelity & Deposit Company, in writing, notice of McKnight's defaults as required; that the Bank did not observe due and customary supervision over McKnight for the prevention of his defaults; that the Vice-President, who was a director, the Cashier, and the Bank itself learned of all the alleged defaults and embezzlements of McKnight immediately after they occurred, and yet neither the Bank nor the Receiver notified the Fidelity & Deposit Company of any of them until long after the Bank was closed on January 18, 1897; that the first notice was an informal letter from the Receiver on February 18, 1897 (R. 34), and this letter did not give any of the particulars of McKnight's defaults and was too long delayed; that no demand with the particulars of the claim of the Bank or the Receiver was filed with the Fidelity & Deposit Company until July 2, 1897; that Rudolph Reutlinger was teller and cashier, and exercised the usual duties of such offices, and that his father was Vice-President and director, and that both were familiar with all the affairs and transactions of the Bank and with McKnight's doings and defaults, and that the directors were always kept informed of the notes and drafts discounted and the loans made and the overdrafts; that the directors and the Bank knew of, and, at the time,

condoned, the said defaults and embezzlements of McKnight, and allowed him to go on in his wrongful course without the knowledge of the said Fidelity & Deposit Company; that, during all the time McKnight was in office, first as Vice-President and then as President, the books of the Bank were out of balance $3,000.00, and were allowed to remain in that improper and dangerous condition; that the officers and directors of the Bank allowed McKnight to be constantly overdrawn in his accounts, and that his overdrafts on January 18, 1896, amounted to $1,340.14, and on January 20, 1896, amounted to $1,460.14, and that, day in and day out, he was overdrawn with the knowledge and connivance of the other officers and directors; that "by their irregular and improper practices the directors of said Bank encouraged said McKight in violating and neglecting his duty as President, and they condoned his misconduct and withheld said information from the defendant, and this defendant would have canceled said bond and would not have remained upon his bond if it had known of his said misconduct;" that, before each renewal of the bond in 1895 and in 1896, the said Fidelity & Deposit Company wrote to the Bank to know if McKnight had up to that time performed his duties properly, and was informed by the cashier and the other officers that McKnight had discharged his duties faithfully; but, on the contrary, the assertions and statements of the said Cashier and the other officers of the bank were false and fraudulent, and were known by them to be false and fraudulent, and misled the Fidelity and Deposit Company, which was relying on the same, and that but for said false and fraudulent statements the Company would not on June 1, 1895, or June 1, 1896, have renewed said bond for a year, and would have canceled said bond, and would thus have avoided nearly all of the losses described in the petition.

On May 1, 1899, the said Receiver filed a Reply (R. 20) which was wholly negative in effect, and on the same day the Fidelity and Deposit Company, with leave of court, filed another Amended Answer (R. 26) which set out more pointedly that the Bank had knowledge of McKnight's doing and defaults immediately after they occurred in the early part of 1896 and later, and that the bank and its officers condoned his defaults and never notified the Fidelity & Deposit Company thereof until

long after the Bank went into the hands of the Receiver in 1897, and that neither the Bank nor the Receiver ever gave the said Company a notice within a reasonable time of said McKnight's defaults and embezzlements, or any of them, and never filed a claim or demand therefor with said Company with full or any particulars thereof as soon as practicable thereafter nor before July 2, 1897, though said Bank and the Receiver knew specifically of said McKnight's act and defaults prior to January 22, 1897, and the Bank knew of many of them prior to January 22, 1896.

On May 2, 1899, the evidence was completed and the court gave its instructions to the jury (R. 48). *The Jury retired and, the first day, were unable to agree.* They were discharged until the following day. On May 3d they still seemed unable to agree, and thereupon they asked the court for additional instructions (R. 62). After receiving a further charge from the court, they rendered a verdict for $10,000.00 against the Fidelity & Deposit Company, the amount of said bond.

The bill of exceptions (R. 28) having been signed, sealed, and filed, the plaintiff in error on July 15, 1899, filed a petition for a writ of error (R. 55), and on the same day filed its assignment of errors (R. 55) and executed a supersedeas bond. The charge of the court, so far as necessary, is stated in the assignment of errors and will be quoted as the points argued are presented.

Specifications of the Errors Relied On.

We maintain that the court below erred as follows:

(1) It was error to admit in evidence as "an immediate notice" of McKnight's defaults the letter of R. H. Courtney, Receiver (Rec. 34), written to the surety February 18, 1897, more than a year after the Bank's cashier and directors knew of his defaults, and not less than two or three weeks after the Receiver himself had notice of them, and it was error in the Court to charge the jury in Instruction 2 (Rec. 57) that the words "the employer shall immediately give the company notice in writing of the discovery of any default or loss" mean "that it was the

duty of the plaintiff in this case to give as soon as reasonably practicable and with promptness notice of the discovery of any default" and that if the Receiver gave the notice "within a reasonable time," etc., it was sufficient. The strong word "immediately" used in the bond was not fairly defined in the charge, when said to be equivalent to the words "as soon as reasonably practicable and with promptness" or "within a reasonable time." Immediate notice implies prompt, vigorous action without any laches or needless delay.

(2) It was error to exclude from the jury (Rec. 46) the petition filed by the Receiver against McKnight on March 6, 1897, in the Jefferson Circuit Court to recover $6,989.00 for four of his defaults for which judgment is asked in this case on a bond for $10,000.00, and the Court erred in charging the jury in Instruction 1 (Rec. 56) that said petition "should have no effect in their deliberation in this case"; that "that was a suit, not upon this indebtedness except in respect to one particular item, that of $3,736.00, but was a suit upon other indebtedness," etc., and the same error was repeated in Instruction 3 (Rec. 57) where it was said that this suit (in the State court) "does not show any thing concerning the particulars of this debt, nor does it show that the plaintiff had known the particulars before this suit was filed." That petition showed that the Receiver knew of four large defaults on or before March 6, 1897, and yet he did not file his claim against the surety till July 2, 1897, although the bond required that the claim should be filed "as soon as practicable."

(3) It was error to instruct the jury in Instruction 3 (Rec. 57) that a claim made on the surety by the Receiver July 2, 1897, was made "as soon as practicable," although the Receiver knew of these defaults in January, 1897, or in the first week of February, and testified (Rec. 34) thus: "At the time we gave that notice [letter of February 18, 1897] we had examined far enough to know he [McKnight] was in default *far beyond the amount of the bond*" [$10,000.00]; and although the Receiver actually sued McKnight March 6, 1897, in the State court on four items sued for in this action and amounting to $6,989.00. The Court said:

"In this case the evidence, I think, will justify you in the conclusion that this claim was made as soon as particulars of this kind were known . . .; that with reasonable promptness, after the particulars of this claim were ascertained by the plaintiff, that his claim was made in such detail that no fault has been found with it so far as has appeared."

(4) It was error to exclude from the jury the letter of the Cashier (Rec. 43) written May 29, 1896, to the surety, stating in reply to a letter of inquiry from the surety to the Bank prior to a renewal of the bond that all moneys handled by McKnight had been accounted for; that his duties had been performed "in an acceptable and satisfactory manner," and that "we know of no reason why the guaranty bond should not be continued." This reply by the Cashier to an inquiry for information addressed to the Bank by the surety was excluded because the surety could not prove that the reply was sent after "there had been special authority from the Board of Directors of the said Bank, authorizing or directing the said Cashier to write such communication, and the court being of opinion that the Cashier had no such power by reason of his office," etc. (Rec. 44.)

(5) It was error to tell the jury in Instruction 5, (Rec. 58, 59, and 60), and in Instruction 6, (Rec. 60), that the knowledge of Vice-President Reutlinger and Cashier Reutlinger of McKnight's defaults, though gotten in the Bank, was not the knowledge of the Bank, and that the Bank could get knowledge only through its Board of Directors:

In Instruction 5, the Circuit Court (Rec. 60), says:

"Now, I suppose in this case, *if the Bank* had known that McKnight was making these drafts for these various fraudulent purposes, such as buying up Councilmen, buying up Aldermen, paying his own private personal debts; *if the Bank* had known that and consented to it, there would not have been a fraudulent act by McKnight for which the Bank could recover against this Company. But if you believe from the evidence that *the Bank* did not know of the fraudulent purposes for which these overdrafts were made; if the overdrafts were made in connection with this matter; if you believe *the Bank* did not know the fraudulent purposes, then that changes the result, because if *the Bank* did not know and still consented to it, it would not relieve the act

of McKnight from the character of being a fraudulent act. So that, as I view this case—you must remember, however, that you are the sole judges of the evidence in this case, its credibility—as I view this case, however, there would be no fraudulent acts upon McKnight's part, limiting my observations now to the overdrafts, there would be no fraudulent act upon his part merely in an overdraft, if there were no fraudulent intent behind it, which was concealed from the Bank." . . .

The defendant excepted because "the foregoing instruction did not submit correctly to the jury consideration of knowledge on the part of the officers or directors of the Bank other than McKnight, which they had or would have had if customary supervision had been exercised."

In Instruction 6 (Rec, 60), the Circuit Court said:

"I do not think that the knowledge of a cashier of a bank, speaking generally, if [is] the knowledge of the bank as to any matter that does not come within the customary or ordinary duties of a cashier or those which have been specially imposed upon him by the action of the Bank. I do not think Mr. R. E. Reutlinger in this case, in respect to any matter which he knew or could do, represented the bank, if it was outside of his ordinary duties; and I do not recall any thing that he knew, so far as the proof shows, that would in any wise affect the liability of the defendant in this case.

"The defendant objected to the foregoing portion of the charge on the ground that the knowledge of the cashier of the acts of McKnight in respect to his overdrafts and his transactions with Britt and Reeder and with Edmunds and Sachs, etc., was the knowledge of the Bank."

(6) It was error to tell the jury in Instruction 7 (Rec. 61) that the knowledge of Director Reutlinger and Director Reisch of McKnight's defaults, though such knowledge was gotten in the Bank itself, was not the knowledge of the Bank, and that such knowledge could not be imputed to the Bank or release the surety unless we could prove that the Board of Directors had such knowledge.

The Court, in its Seventh Instruction to the jury (Rec. 61) said:

"The testimony in respect to the knowledge of *the Bank* of the purpose for which the $2,000 was taken out at half past six or seven in the evening, I say the knowledge of the

Bank respecting that must be proven, in my judgment, in such a way as to satisfy the jury that *the Bank, as distinguished from any mere director of it,* knew of that transaction. . . . If you believe from the evidence that *the Bank* did know of this fraudulent purpose, and that this default of McKnight's, this fraudulent act of McKnight's in getting this $2,000, was known to *the Bank* at the time, then I instruct you that all of the liability of the defendant in this case would cease then, that being the earliest or one of the earliest, if not the earliest of all these transactions. If you believe from the evidence that this transaction was known and condoned by *the Bank* at the time, before these other transactions occurred, then the defendant in this case is not liable. But if you believe, on the contrary, that *the Bank* did not know it, that it was the fraudulent act of McKnight alone, not participated in by *the Bank—when I say the Bank, I mean the Bank, I do not mean any individual director*— then the defendant is liable.

"The defendant objected to that portion of the charge because it declared that the knowledge of an individual director or directors of the acts of McKnight was not the knowledge of the Bank, and the jury should have been instructed that the knowledge of the Vice-Persident, who was a director, and of Mr. Reisch, a director, should be imputed to the Bank itself; but the Court erroneously overruled the objection of defendant and let said instruction stand."

(7) It was error to tell the jury, in substance, first in the Fifth Instruction (Rec. 60) and later in the Eighth Instruction (Rec. 62), when they asked in writing whether the carelessness of the directors in the management of the Bank released the surety, that the carelessness of the directors in the management of the Bank was not a question for their consideration, and that it would not release the surety from liability on the bond, notwithstanding the fact that the Bank had agreed to use "due and customary supervision over the employe for the prevention of default," etc. The court had not defined "due and customary supervision." The jury evidently thought at first that to be "careless" was to fail to use "due and customary supervision over the employe," etc., and yet, after their written question was answered by the court, the jury evidently believed that, in the opinion of the court, the absence of "due and customary supervision" was of no consequence. The jury asked the Court in

writing the following question: "If the jury agree that the directors of the Bank were careless in the management of the Bank, are the jury to find for the defendant?" To this question of the jury the Court replied:

> "Gentlemen of the jury, no such issue as that stated in this question was presented. The mere question of whether or not the directors generally were careless in their management of the Bank is not a question for your consideration, nor would it exempt the defendant from the obligation imposed by the bond sued on. You have already been instructed as to the meaning and effect of the condition of the bond as to due and customary supervision, and outside of that there is no provision as to carelessness."

Brief of Argument.

Page in Brief

The Contracts of Bond Companies, When the Meaning is Clear, Must be Firmly Enforced, . . . 22

Guarantee Co. of North America v. Mechanics Savings Bank & Trust Co., 22 Sup. Ct. Rep. 124.

I. Notice of McKnight's Defaults in the Letter of February 18, 1897 (Rec. 34), was Insufficient, Because not the "Immediate Notice" Required by the Bond, ... 26

Innmann v. The Western Fire Ins. Co., 12 Wend. N. Y. 452.
Edwards v. Lycoming, 75 Pa. St. 378.
Trask v. State Fire Ins. Co., 29 Pa. St. 198.
Railway Pass. Co. v. Burwell, 44 Ind. 460.
Harbour Commrs. v. The Guarantee Co., 22 Canada Sup. Ct. 542.
Queen v. Justice, 4 Q. B. Div. 469.

II. Petition in Courtney vs. McKnight, Filed March 6, 1897, in the State Court (Rec. 46), was Competent Evidence to Show When the Receiver Knew the Particulars of McKnight's Defaults, and Should Have Filed His Claim as the Bond Required, ... 33

PAGE IN BRIEF

III. THE CLAIM MADE BY THE RECEIVER JULY 2, 1897 (REC. 34), WAS TOO LATE, ... 36

IV. THE CASHIER'S LETTER OF MAY 15, 1896, TO SURETY (REC. 43) TO SECURE A RENEWAL OF THE BOND, AND SAYING THAT MCKNIGHT HAD PERFORMED HIS DUTIES SATISFACTORILY WAS COMPETENT EVIDENCE AND BOUND THE BANK, ... 40

Morse on Banking, § 162, 165(*b*), 171(*d*), 103.
Boone on Law of Banking, § 115.
Thomas v. Wells, 140 Miss. 517.
McGee v. The Manhattan L. I. Co., 92 U. S. 93.
Merchants Bank v. State Bank, 10 Wallace, 604.
Xenia Bank v. Stewart, 114 U. S. 224.
Guarantee Co. of North Am. v. Mechanics S. Bk. and T. Co., 22 Sup. Ct. Rep. 124.

V. THE VICE-PRESIDENT'S AND CASHIER'S KNOWLEDGE OF MCKNIGHT'S DEFAULTS WAS THE KNOWLEDGE OF THE BANK (REC. 58, 59, 60), ... 50

Thompson, Common Law of Corp., § 4740.
Morse on Banks and B., § 153.
Distilled Spirits, 11 Wall. 356.
Biswell v. First Nat. Bank, 69 Pa. St. 415.
Birmingham Trust and S. Co. v. Louisiana Bank, 99 Ala. 379.
Veasey v. Graham, 17 Ga. 99.
Pittsburg v. Whitehead, 36 Am. Dec. 186.
Mechanics' Bank v. Gilmartin, 93 Ga. 504.
American Surety Co. v. Pauley, 170 U. S. 559.
Guarantee Co. of North Am. v. Mechanics S. Bk. and T. Co., 22 Sup. Ct. Rep. 124.

VI. KNOWLEDGE OF DIRECTORS REUTLINGER AND REISCH OF MCKNIGHT'S DEFAULTS WAS THE KNOWLEDGE OF THE BANK (REC. 61), ... 64

Martin v. Webb, 110 U. S. 7, 15.
Clerk's Savings Bk. v. Thaw, 2 Mo. App. 367.
National Bank of Asheville v. Fidelity and Cas. Co., 89 Fed. Rep. 819.

PAGE IN BRIEF

Graves v. Lebanon Nat. Bank, 10 Bush (Ky.), 23.
Morse on Banks, § 134.
Conn. Mu. Life Ins. Co. v. Scott, 81 Ky. 540.
Guarantee Co. v. Mechanics S. Bk., 22 Sup. Ct. Rep. 124.

VII. THE NEGLIGENCE OF THE DIRECTORS WAS FAILURE TO USE "DUE AND CUSTOMARY SUPERVISION" AND RELEASED THE SURETY (REC. 62, 60), ... 82

Martin v. Webb, 110 U. S. 15.
Marshall v. Farmers' M. S. Bk. of Am., 85 Va. 676.
United So. of Shakers v. Underwood, 9 Bush (Ky.), 609.
People v. Jansen, 7 Johns. 331.
Board of Education v. Citizens Ins. Co., 30 U. C. C. (Canada), 132. (Note 19 Cir. Ct. Ap. 276.)
Harbor Commissioners v. Guarantee Co., North America, 22 Can. Sup. Ct. 542. (Note 19 Cir. Ct. Ap. 276.)
Phillips v. Foxall, L. R. 7; Q. B. Div. 666.

In order to show, without undue repetition, the errors in the instruction, it will be best to give at once a *résumé* of the main facts contained in the bill of exceptions and relied on in the argument of the legal propositions advanced. All the evidence before the jury was the evidence of the witnesses of the Receiver.

RÉSUMÉ OF PROOF.

The bill of exceptions shows that there was a slight conflict in the evidence on a few points, but as to the main facts there is no dispute. I shall quote the exact language of the bill almost altogether in this résumé.

Adolph Reutlinger was an officer of the German National Bank more than twenty years before Mr. McKnight became an officer. Both Adolph Reutlinger and his son, Rudolph Reutlinger, were bank men of long and varied experience. In June, 1894, McKnight was elected Vice-President. Adolph Reutlinger was President. McKnight then gave the bond sued on herein; but we should have been able to prove, if allowed by the court, that the Bank selected the surety and paid the premium. In January, 1895, McKnight became the President and Adolph Reutlinger the Vice-President. The latter was a director from

the time McKnight came into the Bank to September 5, 1896. Rudolph Reutlinger, his son, was both cashier and teller until the Bank closed.

Adolph Reutlinger, the Vice-President and director, was paid by the German National Bank a salary of $1,500.00 per annum. He "had his desk in the banking room of the German National Bank, and used said desk daily during business hours." (R. 40.) "He was custodian of the Bank's cash reserve of many thousands of dollars, and he had the money in a box to which he alone had the combination." (R. 38.) "Adolph Reutlinger sometimes acted as cashier and teller for his son, Rudolph Reutlinger, while McKnight was President and in the summer of 1896 and prior thereto; Adolph Reutlinger was familiar with the management of the German National Bank during all the time that McKnight was there; . . . frequently examined the books of the Bank; kept the run of the bank and looked to see what notes were discounted by the Bank and what overdrafts existed." (R. 41.)

"It was the custom of the cashier to tell his father, the Vice-President, all that went on at the Bank, and he told his father when McKnight was overdrawn and whenever he discounted a note for him." (R. 38.) "The feeling between Adolph Reutlinger, the Vice-President, and McKnight was not friendly during the year 1896." (R. 38.) "The other employes in the Bank, and Vice-President and Director, Adolph Reutlinger, the father of the cashier and teller, also now and then helped the cashier and teller in straightening out his cash matters, and in that way now and then learned what checks were held back in the cash items." (R. 40.) On March 11, 1895, when the bond of McKnight was being considered because it would have to be renewed on June 1st, 1895, for another year, Adolph Reutlinger wrote to the Fidelity & Deposit Company as follows: "We have about three examinations by the Government a year, and also have frequent periodical examinations." (R. 33.) This letter showed that the Bank officers (rather than McKnight himself) were taking an interest in and attending to the execution of his bond.

The defaults and misdoings of McKnight complained of in the petition began in 1895; but the plaintiff abandoned all the

items prior to 1896. On January 14, 1896, the Hon. Henry S. Tyler, who was then Mayor of Louisville, died. "McKnight became a candidate for the vacant position . . . to be filled by the General Council of the City of Louisville. . . . Among the members were men named Jenne, Sowders, Glover, and Adams; . . . Said four members demanded the payment of one thousand dollars for their use and benefit before they would agree to vote for McKnight and . . . said Edmunds so informed McKnight, who directed the cashier and teller (Rudolph Reutlinger) to take one thousand dollars to another bank and get for Edmunds ten bills of one hundred dollars each, which he did, and delivered said ten bills to the said Edmunds, who took the same and distributed it among the four members, etc." (R. 35.) They signed a pledge to vote for McKnight. "There was testimony conducing to show that said Vice-President . . . heard said McKnight tell the cashier to go out and get said ten bills of one hundred dollars each for said Edmunds; that said Edmunds was a prominent factor in said McKnight's race for Mayor, and was frequently in the Bank during that time; that there were frequent meetings in the bank of persons interested in his candidacy; that during that time Edmunds was frequently seen in conversation with Adolph and Rudolph Reutlinger." (R. 36.) "The contest for Mayor and the subsequent controversy were matters of general notoriety and were discussed in the newspapers, and the said Edmunds was frequently in the Bank conferring with McKnight upon these subjects, and was often seen by, and had conversations with, the Vice-President and directors and the other officers of the Bank, *who knew the purposes of his visits.*" (R. 37.)

For the one thousand dollars given by the Cashier in ten one-hundred-dollar bills to Edmunds, the political manager of McKnight in his race for Mayor, in the heat of the canvass, with the knowledge of the Vice-President and director, he, Edmunds, at the instance of McKnight, gave his individual check on the Bank for one thousand dollars, and Edmunds testified "that he understood that the check was to be taken care of by McKnight." (R. 36.) "The cashier, who was also the teller of the Bank, carried this Edmunds check, at the request of McKnight, as a cash item in his drawer until March 12, 1896—nearly two

months—on which day it was charged to the account of S. E. Edmunds & Company by order of the President, J. M. McKnight." (R. 35.)

It is true that the Cashier and the Vice-President pretend that, in spite of all this, they did not know, at the time, what this money was to be used for; but this court will not believe that men, who had sense enough to be the general officers of a Bank and who must have known something about politics, were ignorant of the purpose which a political leader had, when, in the midst of a race before a Common Council, *he was particular to call for ten one-hundred-dollar bills*, and to need them in that form so badly that the cashier of the Bank had to go out to another bank in the City and get bills of *that exact denomination* for the use of the President, who was the candidate.

J. M. McKnight "was overdrawn in large sums of money from July, 1895, up to fifteen days before the Bank was closed; . . . his overdrafts were frequently as high as $1,200.00; he was overdrawn nearly every day during that period. . . . Mr. Adolph Reutlinger, the Vice-President and director, knew this—the other directors knew of these overdrafts as well as the cashier and teller. . . . The overdrafts of the said McKnight were offered in evidence by the attorney for the plaintiff (the receiver), and it appeared therefrom that the said McKnight had overdrawn his account from the time he became employed by the Bank to the time of the appointment of the Receiver, with the exception of occasional periods." (R. 41.)

On January 21, 1896, J. M. McKnight gave his check for $1,253.00 to the Messrs. Sachs to pay a private claim against himself, and this check on the German National Bank was carried by the cashier and teller as a cash item in his drawer for the benefit of McKnight until March 12, 1896—about seven weeks—and then, at the request of McKnight, this check was charged to the account of S. E. Edmunds & Company. This was done by the bookkeeper on the order either of McKnight or the cashier. "The Vice-President saw McKnight's checks to Sachs for $1,253.00 on the file of the cashier; that it was being held up by the cashier as a cash item; the Vice-President asked the cashier and teller why he was doing that; . . . and said

cashier and teller said he was doing it at the request of McKnight." (R. 38.)

After McKnight was beaten by Mr. Todd in the race before the General Council for Mayor to fill the unexpired term of Mr. Henry S. Tyler, "there was great dissension between the said Todd and the Board of Aldermen and Councilmen, and a majority of the Board of Aldermen—seven in number—were opposed to the Mayor and determined to block legislation proposed by him. Mayor Todd, however, began to make inroads on the opposition to him, and while five of the seven members were working in harmony with him, there were two—Messrs. Britt and Reeder—who were considered wavering, and efforts were made to get them to unite with the five; said S. E. Edmunds acted as a go-between in the negotiations with them; and the said McKnight drew up a paper, intended to be signed by the seven Aldermen, pledging themselves to stand together in their contest against the Mayor, but Britt and Reeder refused to sign the paper unless each of them received $1,000; said Edmunds informed McKnight of this fact, and thereupon the said McKnight requested R. E. Reutlinger, the cashier and teller, to remain at the Bank and keep the vault open after the regular time for closing; McKnight then told the said Cashier 'that he (McKnight) had *a big scheme on hand*, and that it was a big thing;' but did not further explain it; said McKnight caused said Britt and Reeder to be brought to the Bank by said Edmunds at or about 6:30 P. M. on February 6, 1896; said Edmunds, in the presence of said Cashier and said Britt and Reeder, prepared the note hereinafter given, and said Britt and Reeder signed it, and then they went upstairs and signed the agreement hereinafter given, and then the Cashier handed Britt the two thousand dollars in currency by direction of McKnight." (R. 36.) This note was for two thousand dollars, and was due one year after date, *and bore no interest until after maturity and no discount was charged or collected.* In other words, the Cashier knew that the Bank was lending $2,000.00 of its money for one year without interest to two members of the Board of Aldermen before which President McKnight had just been a candidate for Mayor. There was also testimony conducing to show that,

while in the Bank building, Edmunds got $225.00 of this money from Britt and Reader. (R. 37.) In the agreement signed by Britt and Reeder with five other members of the Board of Aldermen, they bound themselves to stand together in all matters before the Board of Aldermen, and to caucus with McKnight before acting. As appears on page 37 of the Record, these controversies between Mayor Todd and McKnight were matters of general notoriety, and were discussed in the newspapers, and, of course, the Cashier and his father, the Vice-President, and the other directors knew all the main facts just as the public did.

The Cashier understood so well the extraordinary nature of this proceeding that he went that evening at 9.30 P. M. to his father's house to tell him, the Vice-President, what had occurred. (R. 37.) "The next morning the Vice-President, Adolph Reutlinger, asked McKnight for an explanation of the matter. McKnight responded that the transaction was all right and that the note was good, and that it would be [in the indefinite future] guaranteed by men of credit, whom he named." Said Adolph Reutlinger, was not, however, satisfied, and notified other members of the Board of Directors, and shortly afterward brought the matter before the Board for its consideration; whereupon McKnight made the same explanation that he had before, and it seemed to satisfy the Board, although the Bank was to get no interest on its $2,000.00 for one year, even if it received the principal. On the morning after Britt and Reeder got the money Vice-President Reutlinger "approached McKnight about the said matter, and McKnight had a long yellow envelope in his hand, and he told the Vice-President that 'those *fellows* had signed it, and that he would not sign that for the City of Louisville;' that 'he had a document there in his pocket which was signed by those fellows;' that 'he had a meeting upstairs and that paper was signed, and he would not sign it for the City of Louisville;' McKnight did not mention the names of the persons who had signed it, but this conversation was had with him by the Vice-President when the Britt and Reeder matter was being discussed." (R. 37–8.) Adolph Reutlinger "noticed that the Bank was to get no interest whatever on the loan to Britt and Reeder for a year; . . . knew that this was an unusual

bank transaction and that there was no promise by McKnight to pay that interest, and no explanation made to him or to the Board of Directors of the interest feature of the transaction." Director Reisch stated that "two or three days after the Britt and Reeder note was executed," "old man Reutlinger" told him: "he said the Bank was opened about six o'clock that night, and Britt and Reeder *and the whole gang there;* he gave a note and got $2,000.00 out of the Bank . . . I just heard after that it was for the Council race, the Todd race, something like that . . . I heard that three days after the money was out of the Bank . . . that the Bank was open after six o'clock, and they got $2,000.00 out of the Bank." The attorney of the Receiver examined Mr. Reisch as follows:

Ques. Now, when was it you heard that that money was intended for the Todd race? . . . Ans. At the same time; old man Reutlinger told me that the same time. . . . That the money was used for the Mayor's race—for the Todd race. . . . Ques That it was money used in that race? Ans. Yes, sir. . . . Ques. Are you certain Mr. Reutlinger told you that? Ans. He told me, not in the Director's meeting, he told me that outside. . . . Ques. Were you in the Director's meeting when that note was considered? . . . Ans. Yes, sir, I believe that note did come up, and McKnight said if Reeder did not pay it, he would.

This testimony shows beyond question that Mr. Reisch, the director, knew three days after February 6, 1896, that McKnight had taken $2,000.00 of the Bank's money under the most extraordinary circumstances, and had given it to two members of the General Council without security and without any interest for a year, and *that the money was used for political purposes*; and it is certain, also, that the matter was brought before the Board of Directors; and, though it is said that McKnight pretended that Britt and Reeder were good for the money, still he never did get any other names on the paper, as he told the directors he would do; and of course, they knew of this default on his part. Besides, he never did give them any explanation why the $2,000.00 of the Bank's money had been lent out without interest for a year. The Vice-President, a bank officer, admits that this was a queer Bank transaction and that he brought it up before the Board because he was not satisfied with

McKnight's flimsy explanation; and yet he knew that McKnight, a few weeks before, had been a candidate for Mayor before the very Board of which Britt and Reeder were members; and, though he knew from his son that Edmunds, who had gotten $1,000.00 while McKnight was running for Mayor, was in this deal, yet, in spite of all this, he pretends that he did not know about McKnight's fraudulent scheme when he had "the gang" upstairs and had gotten them to sign a paper which he "would not have signed for the City of Louisville." There was abundant evidence here on which a jury might have found that two directors, Vice-President Reutlinger and Director Reisch, and the Cashier, Rudolph Reutlinger, and, in fact, the whole Board of Directors, had complete notice of the corrupt purpose and transparent fraud of McKnight; and, under the contract of the Bank with the Fidelity & Deposit Company, it was then their duty to notify the Fidelity & Deposit Company of the whole transaction.

On March 12, 1896, J. M. McKnight also gave another check for $1,650.00 to Messrs. Sachs to pay his private indebtedness, and this also, at his request, was charged to the Louisville Deposit and Collateral Account, in which McKnight had no interest whatever. On June 8, 1896, McKnight gave to the Union National Bank, for Embry, a check on the German National Bank for $3,736.00, and this check, by the request of McKnight, was charged to E. G. Williams, Special (R. 48). The Vice-President and the Cashier knew very well that McKnight had no interest in that E. G. Williams, Special, account; that the Bank alone was interested in that account, and, therefore, that McKnight had no right to charge any money to it. On November 21, 1896, McKnight surrendered some notes signed by S. E. Edmunds & Company, in which firm he had an interest, and caused Edmunds alone to execute notes in the place of them (R. 48). On January 4, 1897, McKnight drew a check on the German National Bank in favor of the Union National Bank, but really for Embry, for $379.96 (R. 39), and this also, at his request, was charged to E. G. Williams, Special, in which he had no interest, as all the officers of the Bank knew.

At divers times the Cashier paid small checks for McKnight and kept a mere memorandum of them as cash items in his

drawer. The Cashier, of course, knew that this was an irregular and improper way of doing business. One of these cash items was on January 12, 1896, for $45.00; two on April 15, 1896, for $25.00 each; and on May 21, 1896, there were four items, one for $76.00; one for $47.15; one for $10.00, and one for $15.00. At all these times, as shown above, McKnight's account was largely overdrawn, and yet the Cashier was carrying these checks as cash items. The whole course of affairs showed that the Cashier and the Vice-President knew of McKnight's irregularities and misdoings, and, *as the Vice-President was not friendly with McKnight*, he, the Vice-President, no doubt reported these matters to the other directors, as it was his duty to do and as he admits he did in the case of the Britt and Reeder note.

In spite of the contract of the Bank with the Fidelity & Deposit Company that it would "observe, or cause to be observed, due and customary supervision over the employe (McKnight) for the prevention of default," and that if the Bank "at any time during the currency of this bond condoned any act or default on the part of the employe which would give the employer (the Bank) the right to claim hereunder, and should continue the employe in its services without written information to the Company, the Company would not be responsible hereunder for any default of the employe which may occur subsequent to such act or default so condoned"—in spite of this distinct contract by the Bank with the Fidelity & Deposit Company, there was (to quote the bill of exceptions) "testimony conducing to prove that the management of the German National Bank by its directors was careless or negligent, and that they did not observe or cause to be observed due and customary supervision over the employe for the prevention of default, and there was evidence conducing to prove that there had not been a complete or customary inspection of the books of said McKnight on behalf of the said Bank once in every twelve months during the continuance of the bond, etc." (R. 43.) There was no notice to the surety of all or of any of these acts. Good faith was not observed toward the surety at all. The officers and directors either purposely concealed all these acts from the surety, or purposely closed their eyes and refused to recognize what any intelligent man must have recognized under the same circumstances.

The Bank was closed on January 18, 1897, by order of the Controller while an examination was going on by Mr. Escott, a National Bank Examiner. McKnight, because of the discovery by the Examiner of his defaults, was arrested the day after the Bank closed. (R. 35.) The Receiver was appointed on January 18, 1897. (R. 33.) He took possession of the Bank on January 22, 1897. The Receiver said: "Almost immediately after the Bank passed into my hands, as Receiver, I began to ascertain the defalcations. The experts, Mr. Hays, a Government Expert, and Mr. Escott, a National Bank Examiner, were at work immediately after Mr. McKnight's arrest. I kept pace with their investigations. It was almost immediately after the Bank closed that these defalcations became known, not all of them, but enough to ground the claim upon." "About a week before it was closed Mr. Escott was at work in the examination; that is my recollection—about a week before." Mr Escott, the Examiner, said: "Mr. McKnight was arrested the following day after the closing of the Bank. We began to get these shortages about two or three weeks after the Bank was closed; they were discovered from time to time—I began to discover them in two weeks."

The Bank was closed on January 18th. (Rec. 74.) The informal letter of the Receiver, sent as an "immediate notice," was not mailed to the Fidelity & Deposit Company until February 18, 1897, a month after the Bank was closed and McKnight was arrested. The letter itself only states that Mr. McKnight "has been found in default to this Bank, and that you will be required to make an indemnity to me as a Receiver to the extent of said bond."

On March 6, 1897, the Receiver filed a suit against McKnight and took an attachment on his property (R. 46), and in that suit the Receiver, though by that time in full possession of all the facts, sought (*a*) to recover $1,000 00 on a note executed by McKnight to the German National Bank on March 19, 1895; (*b*) to recover $300.00 on a note executed by McKnight to the German National Bank on March 16, 1896; (*c*) to recover $2,253.00 with interest from January 21, 1896, for the $1,000 00 paid to Edmunds and the $1,253.00 paid to the Messrs. Sachs; (*d*) to recover $3,736.60 paid by the German National Bank on

a check drawn on it by McKnight, payable to the Union National Bank for the benefit of Embry. In other words, four of the items set up in that suit in the State Court against McKnight, amounting to $6,989.00, were the same items later set up in the petition in the U. S. Circuit Court against the Fidelity & Deposit Company for the amount of the bond, to wit, $10,000; and yet no demand was made on the Fidelity & Deposit Company for the items set up in the petition, aggregating $18,742.74, before July 2, 1897—although the Bank in its contract with the Fidelity & Deposit Company agrees that it, "the employer, (*a*) shall immediately give the Company notice in writing of the discovery of any default or loss hereunder, and (*b*) and shall file with the Company his or their claim hereunder with full particular thereof as soon as practicable thereafter." While the Receiver was taking attachments against McKnight's property, less than two months after the Bank was closed and a few weeks after the first letter of was sent to the Fidelity & Deposit Company, no claim, until July 2, 1897, was given to the surety sufficiently definite to enable the surety to protect itself by similar proceedings against McKnight.

The Contracts of Bond Companies, when the Meaning is Clear, Must be Firmly Enforced.

The questions involved in this case touch the life of bond-companies, and go to the root of the law of suretyship as applied to them. If the decision in this case be allowed to stand, there can rarely be a defense to an action against a bond company as a surety; and, in spite of contract rights, to go on a bond will mean in most cases to pay all losses, no matter how unfair, negligent, or reckless the persons getting the bond may be. The result will be that the premiums for bonds must become higher or the companies must quit business. The loss in the end will fall on employers of ordinary care and honesty who do not need, and do not ask, to be protected against their own bad faith, gross neglect, or gross folly.

Several of the most important questions involved in this case were also directly presented in the case of the Guarantee Company of North America v. The Mechanics Savings Bank & Trust Company, decided by this court on January 6, 1902. The

main questions involved in that case are the same as several important questions in this. In both cases the court below had to decide what is "due and customary supervision" over an officer in a bank, what notice to a surety of an officer's misconduct good faith requires, and how far knowledge of one officer or director is to be treated as knowledge of the bank or the board of directors. The true meaning of the American Surety Company v. Pauly, 170 U. S. 160, has been made clearer by the case just cited. According to the principles of those cases, the petitioner in this case should have been exonerated. In spite of a strongly adverse charge in the circuit court—in spite of the natural prejudice of a jury against a corporation like a bond company—the jury evidently wanted to find a verdict for the surety; because the jury were long hung and, on the second day, would not find for the Receiver without asking for a further charge; and the second charge was so strong against us that they evidently felt that there was nothing else to do but find a verdict for the Receiver, even though it were not consonant with their own ideas of justice.

In the argument in the Circuit Court of Appeals the question came up whether the rights of a bond company as a surety were different in any respect from the rights of an individual bound as a surety. Only one difference has been or can be logically made. It has properly been held that where the construction of the contract of the surety company is doubtful, it will be construed against the surety, because such a contract is prepared by skillful attorneys of the surety company, and, in such a case, surety companies will be treated as insurance companies are treated; but a surety company, like anybody else, has a right to limit its liability by contract, and, when the contract is clear, it must be enforced. It can not be ignored or brushed aside merely because the contract was made for a consideration. All contracts are based upon a consideration, and, except in ascertaining what the meaning of the contract is, no distinction can be drawn between the contract of an individual surety and the contract of a corporation surety. The essential contract rights of corporations and individuals, under like circumstances, must be the same wherever impartial courts enforce the law. In the case at bar it is not pretended that there is any ambiguity in the con-

tract. The meaning is clear, and the only question is whether this clear contract shall be reasonably and fairly enforced. We are only asking that facts, which would have exonorated a private surety without compensation under all former decisions, shall also exonorate the Fidelity & Deposit Company, which went on the bond for a small fee. We only ask that we shall be held entitled to the same good faith and the same notice that any private surety would have been entitled to, and without which the surety would have been released. All this should be made plain by the Supreme Court for the guidance of the bond companies and the courts.

In times past, courts, in determining the rights of private persons who have become bound as surities, have not sought to ascertain whether the surety became bound for a good or a valuable consideration, nor to whom nor from whom the consideration moved. Whether a surety signed for money or on account of friendship was not inquired into, and made no difference in his rights, and would make no difference in his rights to-day. The courts have never attempted to make distinctions between valuable considerations in any form of contracts, and whether the Fidelity & Deposit Company was or was not paid to sign McKnight's bond can not be considered in this case.

Happily this court in the case of the Guarantee Company of North America v. The Mechanics Savings Bank and Trust Company, in construing a contract in its main features identically the same as ours, has condemned efforts "to refine away" the rights of these sureties. After quoting from the Pauly case the rule to be observed where the terms of the bond are ambiguous, the Chief Justice, that the rule might not be stretched beyond proper bounds, said:

> "But the rule can not be availed of to refine away the terms of a contract expressed with sufficient clearness to convey the plain meaning of the parties and embodying requirements, compliance with which is made the condition to liablilty thereon. Whatever the common law duty on the part of the employer to notify the guarantor of the fraud or dishonesty of the employe whose fidelity is guaranteed, the parties to the contract undertook to declare the duty of the bank to the company in certain specified particulars. It required that the employe should not have been guilty of previous default or dereliction within the

> knowledge of the employer. It provided for notification of any act of the employe which might involve a loss, without unreasonable delay after the occurance of the act came to the knowledge of the employer. . . . The question was not merely whether the conduct by the bank was contrary to the nature of the contract, but whether it was not contrary to its terms."

This court fairly but inexorably enforced the plain letter of that contract. The court did not refine away its provisions.

In the case of Rice v. the Fidelity & Deposit Company, 103 Fed. Rep. 427 (1900), the Circuit Court of Appeals firmly enforced the agreement between the employer and the surety to the effect that the "statement," which said that the bookkeeper would countersign all checks of the employe, should be the basis of the bond and its observance a condition precedent to recovery on the bond.

This court knew that bond companies serve a useful purpose. They are in their infancy. Unless their premiums are increased it is doubtful whether many of them can live. The percentage of loss would be enormous if employers could be negligent or reckless and yet hold the surety for embezzlements that could be prevented by ordinary care. The desire or demand on the part of the public for suretyship or guarantyship by corporations rather than by private individuals is steadily increasing, and surely the courts should do nothing to prevent the gratification of such a reasonable desire. The competition between the companies, of which there are now a great many, will inevitably reduce the cost of the premium in each case to the lowest point consistent with reasonable profit. The action of competition in this way can be relied on with perfect confidence. Hence, in a short time the premium will become so small that it will merely cover the risk of loss, when there has been reasonable care on the part of the employer to prevent loss. If the courts, however, lay down all the bars and say that the surety must pay, practically in every case, no matter how gross the carelessness or negligence of the employer may be, these companies must either go out of existence or the rate of insurance or premium must become so high that it will be a great burden upon the people of ordinary honesty and reasonable diligence. It would be highly inequitable

and unwise to make such suretyship too expensive for diligent and business-like men in order that there might be absolute protection for those who are totally negligent and unbusiness-like, and who invite, by their want of care and good sense, the defalcations of their employes.

It is not contended that employers must use such care and intelligence as will render defaults almost impossible or very rare. It is only contended that it is for the benefit of everybody but the incompetent or the slothful that employers who take bonds must still show reasonable attention and diligence in guarding against the defaults of their servants; and that sureties, whether private individuals or corporations, shall be treated with candor and fairness. To allow reckless employers to hold sureties in nearly all cases will encourage fraud and crime—will multiply temptations to unwatched employes and increase the cost of a surety to thrifty and conscientious employers. *Et ne nos inducas in tentationem.*

FIRST POINT.

Immediate notice of McKnight's defaults was not given the Surety by the Bank or the Receiver. The words "immediate notice" are stronger than the words "as soon as reasonably practicable and with promptness" or "within a reasonable time"; and "immediate notice" implies prompt, vigorous action without any laches or needless delay; and where there is no dispute as to the facts, this question is one of law; and two or three weeks' delay in writing a short letter as a notice to the Surety after fraud has been discovered is not "immediate notice."

Under the bond the surety was entitled to immediate notice of the discovery of McKnight's first default (1) from the Bank in January, 1896, but certainly (2) from the Receiver in January, 1897. That notice was not given, and the Circuit Court of Appeals has decided in this case that "immediate notice" is the same as the words "as soon as reasonably practical and with promptness" or "within a reasonable time." We respect-

fully submit that that is not consonant with the authorities. The bond provides as follows: "That the German National Bank shall (*a*) immediately give the Company notice, in writing, of the discovery of any default or loss hereinafter, and (*b*) shall file with the Company his or their claim hereunder, with full particulars thereof, as soon as practicable thereafter," etc.

Here two things are stipulated for: (1) an immediate notice, and (2) a claim "as soon as practicable thereafter." The circuit court in the charge to the jury, and the Circuit Court of Appeals have in effect decided that the word "immediate" is exactly the same in meaning as the words "within a reasonable time," or "as soon as practicable thereafter"; and yet the difference between these words is here brought into sharp contrast by the contract itself. The parties in interest evidently intended to make a clear distinction, which the court has ignored.

It is manifest that Vice-President and Director Reutlinger, and Cashier Reutlinger and Director Reisch, knew of McKnight's defaults in January, 1896, and hence an "immediate notice" at that time should have been sent to the Surety by the Bank. If we concede, however, merely for the sake of argument, that the knowledge of these officers of the Bank was not the Bank's knowledge, still the Surety was entitled to immediate notice from the Receiver in this case, and such immediate notice was not in fact given. We were entitled to notice as soon as he discovered a single default—"any default or loss" for which we could be held bound. He could not wait till he discovered all. If, as the Circuit Court of Appeals has held, a letter such as Receiver Courtney wrote to the Surety on February 18, 1897, is sufficient in form and substance, there is no reason why such a letter could not have been written and sent through the mail within one day or two days after his discovery of the first default. The writing of such a letter was a matter of a few moments, and such an important business transaction, so easily attended to by him and so vital to us, should not have been delayed a day. The Circuit Court of Appeals admits that he delayed the writing of such a short note without any excuse whatever for at least two or three weeks. That was not good faith to the Surety, and was not a compliance with the bond. It was highly important to the

surety that it should know of its peril immediately after the Bank Examiner first discovered a default, or at least immediately after the Bank was closed January 17, 1897, and McKnight (the following day) *was put in prison for his frauds*. The Receiver certainly knew of these facts as soon as he was appointed, Janu-18, 1897, or as soon as he took charge of the Bank, January 22, 1897. The surety should have been allowed a chance at once to take steps to secure indemnity from McKnight or to attach his property. To keep the surety in the dark for a month or for even two or three weeks, while McKnight's property could easily have been put beyond the reach of the surety, when the Receiver had only to spend five minutes in writing such a notice as he sent to the surety, was unreasonable and unpardonable. It was not immediate notice, and it was in clear defiance of the plain letter and spirit of the bond. The Receiver might with reasonable excuse have delayed two or three weeks to make out a formal claim and prepare proofs and get exact information for such a document, but he did not need a single day for the petty task of writing such a letter as he in fact wrote on February 18, 1897.

The trial court, in Instruction 2, said to the jury (Rec. 57):

"It [the clause about immediate notice] did not mean that as soon as one [default] was suspected that notice should be given, but if you believe from the evidence that *within a reasonable time* after the Receiver in this case—and you must remember that he is the receiver merely, and that he knew nothing about the management of this Bank, nothing of its affairs until he was appointed—if you believe that *within a reasonable time* after he discovered, actually discovered, a default, he gave the notice of the 18th day of February, 1897, you are at liberty to infer that that part of the obligation of this bond has been performed."

Bouvier's Law Dictionary, quoted by the Circuit Court of Appeals, says: "The words 'forthwith' and 'immediately' have the same meaning. They are stronger than the expression within a reasonable time,' and imply prompt, vigorous action, without any delay, and whether there has been such action is

a question of fact having regard to the circumstances of the particular case."

In other words, this authority does not agree with the opinion of the Circuit Court of Appeals and the circuit court that the word "immediately" means only "within a reasonable time." If, as the Circuit Court of Appeals admits, the Receiver and the experts "began to discover them (the defaults) two or three weeks after the bank was closed," or in other words, that "the discovery was first made between the second and ninth of February, 1897," and yet that the Receiver did not write his short note to the surety until February 18, 1897, that certainly was not "prompt, vigorous action without any delay." That was gross laches, and a great wrong to the surety. No excuse whatever has been offered for the long delay of so simple a matter.

The Circuit Court of Appeals said:

> "We have already said no notice is required until the Bank had knowledge of facts which would justify it in charging dishonesty. . . . Assuming that the defalcations were becoming apparent to the experts so that they began to discover them two or three weeks after the Bank was closed, we can not say as a question of law that such facts had been discovered as would justify a prudent man in charging another with dishonesty so as to require notice, etc."

It is clear that the Bank had knowledge of the Edmunds fraud and the Britt and Reeder fraud in January, 1896, and that these facts would have justified it in charging dishonesty on the part of McKnight, and that was a year before the Bank was closed; but even the Receiver, after it was his duty to give an "immediate notice," delayed too long, for it is conceded that the Bank, because of an examination by the Bank Examiner, and the discovery of fraud, was closed on the 18th of January, 1897. "Mr. McKnight (Record 43) was arrested the following day after the closing of the Bank." In other words, McKnight was promptly charged with dishonesty. Evidently "such facts had been discovered as would justify a prudent man in charging him with dishonesty." The Receiver himself said (Rec. 42): "Almost immediately after the Bank passed into my hands as Receiver I began to ascertain the defalcations. . . . The experts were at work immediately after Mr. McKnight's arrest. *I kept pace with*

their investigation. It was almost immediately after the Bank closed that these defalcations became known, *not all of them, but enough to ground the claim upon.*" The Examiner himself said: "We began to get these shortages about two or three weeks after the Bank was closed. They were discovered from time to time. I began to discover them in two weeks."

With the Bank closed by the Controller of the Currency for fraud after a previous examination by the Bank Examiner; with McKnight under arrest evidently for such fraud, and with the Receiver fully informed of the very first discovery of the frauds, which must have been discovered even before two weeks, but which were undoubtedly discovered in two weeks after the Bank closed, the Receiver, though bound to give us immediate notice, would not undertake the petty labor of writing eleven lines to us until two or three weeks had passed—until from fourteen to twenty-one days had passed, if we take the estimate of the Circuit Court of Appeals. Was that fair to the surety? Was that "prompt, vigorous action?" Was it reasonable or in accordance with the letter or spirit of the bond?

In the case of Innmann v. The Western Fire Insurance Company, 12 Wend. N. Y. 452, the court said that even *one week* would not be "forthwith." In Edwards v. Lycoming Insurance Co., 75 Pa. St. 378, the court held that a notice delayed *eighteen days* was not "forthwith." In Trask v. The State Fire Insurance Company, 29 Pa. St. Rep. 198, the court held that a notice delayed *eleven days* was not immediate notice. In the Railway Passenger Association Company v. Burwell, 44 Ind. 460, it was held that a notice delayed *six days* was not "immediate" notice. In Harbour Commrs. v. The Guarantee Company of North America, 22 Canada Sup. Court, 542 (see note 19th C. C. A. 276), it was held that a delay of *a week* was not immediate notice. In the Queen v. The Justice of Berkshire, 4 Q. B. Div. 469, a delay of *four days* was held not to be immediate notice, the Court saying: "The words 'forthwith' and 'immediately' have the same meaning. They are stronger than the expression 'within a reasonable time,' and imply prompt, vigorous action, without any delay, and whether there has been such action is a question of fact having regard to the circumstances of the particular case."

In the case of Streeter v. Streeter, 43 Ill. 155, the court held that immediate notice had not the same meaning as the words "as soon as could practically be done." In our case the lower court in its charge to the jury told them that "immediate" notice meant "that it was the duty of the plaintiff in this case to give, as soon as was reasonably practicable, and with promptness notice of the discovery of any default;" that "immediate" notice meant "within a reasonable time." In this case there was no dispute as to the facts bearing on the question of the time of the Receiver's discovery of McKnight's defaults and the time he gave the notice. All the testimony on that subject was offered by the Receiver, and there was practically no conflict in the evidence as to this point. In May on Insurance, Section 462, quoted by the Circuit Court of Appeals, it is said:

> "Whether due diligence has been used in giving the notice is a question which is ordinarily left to the jury to be found from all the circumstances in the case. Where the facts and circumstances bearing upon the question of due diligence are not in dispute, it becomes a question of law for the Court."

In the Pauly cases there was a conflict of evidence as to when the Receiver got notice of a default; but it was certain that the Receiver gave *a notice in two or three days* after the Examiner reported that there was a default. In our case, the Receiver, as he admits, kept pace with the Examiner, who discovered defaults in two weeks after the Bank was closed. McKnight was arrested one day after the Bank was closed, and yet *the Receiver's short letter was not written to the surety until thirty days after McKnight's arrest, and thirty-one days after the Bank was closed*, and at least ten to seventeen days after the Examiner and Receiver had discovered at least some of the defaults set up in this action. Here there were not merely suspicions of fraud. The President was actually arrested for fraud the day after the Bank closed.

In the American Surety Company v. Pauly, 170 U. S. 160, it is said:

> "There was evidence tending to show that although the Receiver had reason, in the months of January, February,

> March, or April, 1892, to believe that there were *irregularities* on the part of Collins as President of the Bank, he did not become aware of any specific acts of *fraud* or dishonesty by him until the expert book-keeper employed to examine the bank's books informed him *a few days prior to May* 23, 1892 [the date of the notice], that he had discovered false entries showing fraud and dishonesty on the part both of Collins and O'Brien."

In the American Surety Co. v. Pauly, 170 U. S. 139, the suit on the bond of Cashier O'Brien, Justice Harlan said:

> "The Receiver was not aware of 'the amounts or specific conditions' of such irregularities, nor of any specific act of fraud or dishonesty upon the part of the cashier, until the expert book-keepers had completed their examination of the books of the Bank *about May* 23, 1892, *on which day* the Receiver wrote to the Surety Company, etc."

In another place (p. 139) Justice Harlan said:

> "*Towords the end of May* the experts made certain discoveries involving the fidelity and integrity of O'Brien as cashier, of which Bloodgood gave notice to the Receiver [May 23d]."

In other words, the Supreme Court thought that the receiver did not get notice of any default of the president or cashier until a few days before he sent the letter of May 23d, and that that was immediate notice, or at least that the jury might find such notice to be immediate. In the McKnight case the directors and the Cashier had known of the Edmunds and the Britt and Reeder defaults for more than a year; the Edmunds check for $1,000.00 of January 21, 1896, which was fraudulently carried as a cash item till March 12, 1896, and was never paid, and the Britt and Reeder note of February 6, 1896, for $2,000.00, which bore no interest and was never paid, were not forgotten by the officers and directors when McKnight was arrested; and both these transactions were matters which the Bank Examiner and the Receiver must have learned immediately when the bank closed and McKnight was under arrest for fraud, and they certainly knew of some one of these defaults at least two weeks before the letter was written, and

may have known of them four weeks before. It seems clear, therefore, that the court erred in allowing the Receiver in this case to offer his letter of February 18, 1897, as "immediate notice" under the contract. In some insurance cases the courts have been indulgent where ignorant or unbusiness-like people have been a little slow in sending a notice; but here we have an expert—a Receiver who understands the meaning of words and the need of speed and the danger of delay—and who waited unreasonably long before writing a short letter to the surety as a notice under the bond.

The Circuit Court of Appeals criticised the form of the exception taken to the admission of the letter of the Receiver of February 18, 1897, as an "immediate notice" and to the form of the exception to the charge; but the objection to that letter as an immediate notice was made (1) in the pleadings (2) when the evidence was offered (Rec. 33), and (3) when the charge (Rec. 49, 57) was given; and both the counsel for the Receiver and the Court understood the exception to be exactly what it was meant to be, and this is shown by the words of the Court in Instruction 2 (R. 57). Nobody was misled by the form of the exception, and it is sufficient.

SECOND POINT.

Petition in Courtney v. McKnight was competent evidence.

My *second point* is that the court erred in telling the jury, in Instruction No. 1 and in Instruction No. 3, that the petition in the case of Courtney v. McKnight in the Jefferson Circuit Court, filed March 6, 1897, on which an attachment was issued, should have no effect in their deliberations and was not competent evidence, because it did not "show any thing concerning the particulars of this debt," and did not show "that the plaintiff had known the particulars before this suit was filed" against the plaintiff in error. As appears in the resume of the facts, the petition referred to shows that, on March 6th, at least, and no doubt long prior thereto, the Receiver knew of *at least four* of the defaults of McKnight, aggregating $6,989.00. The first

paragraph of the petition sought to recover of McKnight $1,000.00 on the note executed by McKnight to the Bank March 19, 1895, and that is the tenth item in the account set up in this case (Rec. 5); and the third paragraph of the action in the State Court sought to recover of McKnight $2,253.00 with interest from January 21, 1896; that is the $1,000.00 gotten by Edmunds on January 21, 1896, and the $1,253.00 paid to Messrs. Sachs for McKnight's indebtedness on the same day. The fourth paragraph sought to recover the $3,736.00 which on June 8, 1896, was paid by McKnight to Embry by means of a check drawn on the German National Bank in favor of the Union National Bank. These four items amounted to $6,989.00, and these four defaults were known with all their particulars on March 6, 1897, as appears from that petition in Courtney v. McKnight. The lower court, in Instructions No. 1 and No. 3 (Rec. 56 and 57), erred in telling the jury that said petition showed only that the Receiver knew of one of these defaults, namely, the check for $3,736.00 given to pay the Embry debt. The court (Rec. 56) said:

"Before, however, going into that I should have said, if I have not, that the action that was brought in the Jefferson Circuit Court, some time in March, 1897, for the recovery of certain debts, should have no effect in your deliberations in this case. That was a suit, not upon this indebtedness except in respect to one particular item, that of $3,736.00, but was a suit upon other indebtedness. It is a suit in several paragraphs, one of which is upon notes and obligations executed by McKnight to the Bank, but the only one of the items mentioned in that suit that is contained in the suit in the State Court is that of $3,736.00, which represents money that had been paid through the Union National Bank upon the debt of one Embry. I need not go into any reasons with you upon the subject, but the court is clearly of the opinion that no importance should be attached to that suit or any of its affirmations in your deliberations in this case . . ." Counsel for defendant objected and excepted to the foregoing portion of the charge. Three of the items set out in said action are now embraced in this action on said bond; and the plaintiff's notice thereof to defendant and the demand upon defendant therefor were delayed too long."

In the Third Instruction (Rec. 57) the court said:

"One of the most important reasons why this suit, that was filed in the State Court, was not regarded as important evidence in this, was that it does not show anything concerning the particulars of this debt, nor does it show that the plaintiff had known the particulars before this suit was filed."

This language of the court evidently led the jury to believe that they must pay no attention whatever to that suit in determining whether or not the Receiver filed with the surety his CLAIM "with full particulars thereof as soon as practicable thereafter." The court was led into this error by overlooking the fact that in the third paragraph of that petition the Edmunds check for $1,000.00 was combined with the check to Messrs. Sachs for $1,253.00. Many of the items of default set up in this suit against the surety were abandoned, but of those on which the surety was finally held liable for $10,000.00, three amount to $5,989.00. The effort in this suit to recover $1,000.00 on that note of March 19, 1895, was abandoned shortly before the trial began. These facts show that the petition in the action in the State Court was competent and important evidence bearing upon the question whether the Receiver, after he had information and particulars definite enough for an action and attachment in the State Court for $6,989.00, had a right to delay for *nearly four months* a claim for $10,000.00, the amount of the bond, for under the contract, he was bound to file it with the Company "as soon as practicable."

THIRD POINT.

The Claim Made July 2, 1897, was Too Late, and Instruction 3 (Rec. 57) was Wrong.

My *third point* is that the Bank, after it knew of the Edmunds check, and certainly after it knew of the Britt and Reeder note, in January and February, 1896, ought to have made a demand upon the Surety in 1896, but that, at any rate, the Receiver should have made his demand long before July 2, 1897. As the counsel for the Receiver has contended that this claim is in time, if filed in six months, it is important to analyze the language of the bond.

The contract (Rec. 29 and 32) provides that the Bank shall recover for a default only upon the three following conditions:

(*a*) "That the employer shall immediately give the company (surety) notice in writing of the discovery of *any* default [a single default] or loss hereunder;
(*b*) and shall file with the company his or their claim hereunder, with full particulars thereof, as soon as practicable thereafter;
(*c*) and no claim which shall not be so filed by the employer with the company within six months after the expiration or cancellation of this bond, or within six months after the employe shall have ceased to be in the employer's services, shall be payable hereunder."

The proviso "C" clearly does not mean that the employer may delay six months to file his claim under "B" if it is practicable to file said claim sooner with full particulars thereof. The proviso "C" merely means that after the bond has expired or has been cancelled more than six months, or after the employe has ceased for more than six months to be in the employer's service, there shall be no right to recover on the bond, notwithstanding a claim may have been filed as soon as practicable after the ground for it has been discovered. In other words, employers must discover defaults at all events within six months after the bond expires or the employe leaves the service, but they still can not recover unless (*a*) they give immediate notice and (*b*) file their claim as soon as practicable thereafter, with full particulars,

etc. *It was not proper for the Bank or the Receiver to wait six months or until all was known of McKnight's defaults to file that claim.* The lower court in the case of the American Surety Co. v. Pauly, in the suit on the bond of O'Brien, the cashier, as appears in 170 U. S., page 146, said that the defaults of O'Brien and Collins were not discovered until some time after May 1, 1892, although there had been suspicions before that date; that the first notice was sent on May 23, 1892, and that the formal demand or claim was made on June 24, 1892, and the Court also said:

"Now I charge you as a matter of law, that, if the facts were as they were assumed to be at the outset of the trial—that is, that the discovery was made early in February, and notice was not given until July—that was not notice with reasonable promptness. And I do not know but that I could charge you, as a matter of law, that, if the facts were discovered in the early part of February, and notice was not given until the latter part of May, that was not notice given with reasonable promptness. But, *if you come to the conclusion that the discovery was not made until the latter part of May*, then, in view of the situation of the plaintiff, you may reasonably come to the conclusion that it exercised proper diligence in sending the notice."

The Supreme Court said this instruction was correct. In the Pauly case *the claim was made by the Receiver about thirty days after the notice of May* 23, 1892, and that delay of *one month* was held not to be too long. But in the McKnight case the claim was not made from February 18, 1897, when the letter was written by the Receiver, until July 2, 1817, about *four months and a half*. On March 6, 1897, as we have shown, the Receiver knew of four items of McKnight's defaults, amounting to $6,989.00, and yet the Receiver made no claim or demand for nearly four months after that date. This was certainly not complying with the agreement of the Bank that it would "file with the Company his or their claim thereunder with full particulars thereof as soon as practicable thereafter." The Receiver said (Rec. 34): "At the time we gave that notice (letter of February 18, 1897) we had examined far enough to know he (McKnight) was *in default far beyond the amount of the bond.*" If so, the

claim should have been made then, not four months and a half later. We were interested only to "the amount of the bond," and we were entitled to a claim for that amount "as soon as practicable" for we, like the Receiver, might have wished (after we paid the claim) to take an attachment against McKnight's property.

The giving of the notice by letter on Feb. 18, 1897, even if it were such an immediate "notice" as the contract required, did not abrogate or dispense with the other right which the Surety Company had by its contract, namely, the right to have delivered to it the Receiver's demand or "CLAIM hereunder with full particulars thereof as soon as practicable thereafter." The Court can not say, as a matter of law, where the Surety Campany and the Bank have by contract given the Surety Campany (1) a right to an immediate notice, and (2) a right to a claim or demand with full particulars, as soon as practicable, that the Surety Company can be deprived of one of its rights so agreed upon. This Court can not say, as a matter of law, that after the Surety Company got that informal and indefinite letter from the Receiver about McKnight's defaults, it could no longer insist upon its right to have a CLAIM with full particulars *as soon as practicable.* This Court might think that such a claim with full particulars was of no special benefit to the Surety Company, but that was not the opinion of the Surety Company and the Bank when the contract was made. The Surety Company would not have required the Bank to file with it a claim with full particulars of defaults as soon as practicable, if the Surety Company and the Bank had not understood that such a right was valuable to the Surety Company; but whether such a right was of any practical value to the Surety Company or not, it is entitled to enforce its contract as to this matter. The Receiver did not deny the right of the Surety Company to have such "a CLAIM with full particulars as soon as practicable;" and hence, this Court, it seems to me, ought to say as a matter of law that more than four months' delay after the sending of the letter of February 18, 1897, and nearly four months after the filing of that suit by the Receiver against McKnight with a prayer for attachment against his property, was not a compliance with the agreement or contract to file the claim

with full particulars as soon as practicable. The letter of February 18, 1897, gave the Surety Company no definite information on which it could take legal proceedings to protect itself against loss by reason of McKnight's defaults. For the protection of the surety it was necessary that it should have, as soon as practicable, a claim with full particulars of his defaults so that it could, if necessary or useful, proceed at law against McKnight's property. The claim in this case was for $18,742.74, and that was the amount sued for in this action, and yet, on the trial, the Receiver abandoned more than one third of that claim; and besides, nearly seventy-five per cent of the sums which the Receiver sought before the jury to hold us for appeared in that petition of Courtney v. McKnight, on March 6, 1897. After the Receiver wrote us that vague and indefinite letter of February 18, 1897, from which it did not appear whether McKnight's defaults would be very small or very large, he took an attachment on March 6, 1897, against McKnight's property on account of some defaults in which we were not interested, as well as some in which we were interested, and after having thus sought to hold McKnight's property, not for our benefit, the Receiver held back from us, for four months, the only information on which we could have acted in an effort by suit or otherwise to protect ourselves against McKnight's defaults. The Receiver had no right to hold us back in this way while he was seeking to cover McKnight's property by an attachment lien which would not have protected us entirely, and which might have deprived us of the only property to which we could have resorted for securing our claim. We could not pay the Receiver until the regular claim was presented to us and we could not safely sue McKnight until we had paid the claim and thus had become his creditor. Promptness by the Bank or Receiver in presenting the claim was vital to our interest. As the principal prejudiced the surety by delay, the surety, under its contract, is released. This claim was not made until about five months and a half after the Bank was closed and McKnight arrested, about four months and a half after the vague notice in the letter of February 18, 1897, was sent, and nearly four months after the Receiver, on March 6,

1897, had sued McKnight and attached his property. No reason or excuse is given for the delay.

FOURTH POINT.

A Cashier's reply in due course of mail to a letter of inquiry addressed by a surety to the Bank itself is admissible as evidence against the Bank without preliminary proof by the surety that the Board of Directors gave formal or special authority to the Cashier to write that particular letter; but the contrary principle has been established in this case by a majority of the court below in misapprehension of the meaning of the Pauly case.

The surety, on May 15, 1896 (Rec. 43), wrote a letter, not to the Cashier, but to the German National Bank, and asked the Bank to certify whether or not McKnight's books and accounts were correct, and whether all moneys handled by him had been accounted for. A proper reply to that letter was a condition precedent to the renewal of the bond, as the Cashier and Bank knew. The Cashier, in due course of mail, returned the certificate on May 29, 1896, and said: "He has performed his duties in an acceptable and satisfactory manner, and we know of no reason why the guarantee bond should not be continued." This letter was written by a Cashier who personally knew all the evidence of McKnight's guilt, as shown in the resume of facts. The agent knew that he could not get the bond without that statement; and he knew that the statement was false.

The court below refused to allow that letter or certificate of the Cashier to be read to the jury, because the surety was not able to prove that there had been a formal vote by the Board of Directors authorizing him to write such a letter. The Bill of Exceptions (Rec. 44) says: "And it not appearing that there had been *special authority* from the Board of Directors of the said Bank, authorizing or directing the said Cashier to write such communication, and the court being of the opinion that the Cashier had no such power by reason of his office, the same was

not binding upon the said Bank, and excluded the same as evidence."

It can not be disputed that a surety is entitled to an honest and candid answer from the employer when inquiry is made; and, when the answer is returned in due course, and by one apparently authorized to answer, the surety should be able to rely upon the answer; but the court below held that the answer of a cashier to a surety, in due course, can not be proven unless proof is made that by formal action of the board itself he was authorized to write that particular letter. Such proof would generally be impossible. This decision was based upon the language used in the American Surety Company v. Pauly, and yet we respectfully submit that the decision in that case will not bear such a construction.

In the *first* place, we sought to show by the Cashier himself that his own bond was paid for by the Bank and that this McKnight bond was not obtained by McKnight for his own benefit, but that the Bank itself (R. 54) selected the surety of the President and the Cashier and paid for the bonds, and was interested in getting the bonds executed and in having them renewed, and that "all these bond matters were discussed by the Board of Directors," and that the Cashier when he was replying to the letter of the surety to the bank "knew the bond had to be renewed, and * * * wrote the letter to the Company on that account," and thus obtained for the Bank the bond which it accepted on these terms and on which it now sues while attempting to repudiate and disown the means by which it was obtained by its agent; but the lower court would not allow us to prove these facts. In the *second* place, because the Supreme Court in the Pauly case said that a president in a mere letter of recommendation for the cashier when he was first applying for a bond, when there was no contract to the effect that the president's statement should be the basis of the bond, and when there was collusion between the president and the cashier to defraud the bank, could not bind the bank by his statement, the Circuit Court

in this case—in which the contract and the facts are entirely different—has held that a cashier, when the bank desired a renewal of the President's bond, could not answer an inquiry by a surety in due course of business and state as a fact how the President had performed his duties unless the cashier had been first authorized to answer by a formal resolution of the Board of Directors.

A contract made by a bank with a surety is like any other contract made by a bank, and a letter written by a cashier on that business is like any other letter written by him on the business of the bank. If the Courts attempt to draw distinctions between the various contracts made by a bank and between the multitudinous letters which a cashier must write in the ordinary course of business, and to say that, as to certain contracts, he can speak for the bank in its correspondence without formal proof of his authority, but, as to other contracts, he can not write without a special authority from the board, and that when he has written a letter it can not be proven till formal proof is made of his authority to write that particular letter, the Court will get into endless difficulties, and the public will never be able to rely upon the letters or assurances of the only officer who is, by usage and by law, authorized generally to act and to write for the bank. The decision in this case in not a logical corollary of the Pauly case, and is in conflict with the text-books and decisions which have long settled the law as to the inherent powers of a cashier. Not only will this decision unsettle the law, but it will make the transaction of business with a bank troublesome and unsafe. One of the judges of the Circuit Court of Appeals did not approve this departure from a well-settled rule.

There is a wide difference between the duties and powers of a President and a Cashier. The Cashier is the chief executive officer of the bank. To him is entrusted the duty of conducting the correspondence of the bank. Persons who receive letters from him about the contracts of the bank can not require, as proof of his authority, a certificate of the board that he has been authorized to act. That would stop the business of a bank. If he said in his letter that he had been authorized to act, outsiders

would still not know whether his statement was true. To write at all is a tacit assurance that he has been authorized to write. When inquiries are addressed to the bank (as in our case), his answer must be presumed to be authorized, at least until the contrary is shown. To require proof of his authority in each case, or in ordinary cases, would be unreasonable and clog business, and would prepare endless traps for honest but unwary men. If the law were so unreasonable, a bank could often get an advantage of others by simply taking no formal action that could be proved, and by giving to the Cashier no special authority that could be established by evidence in court. While he was entrapping unsuspecting parties dealing with him in good faith on the assumption that he was authorized to do what he held himself out as able to do, the Board could sit still complacently and having eyes see not, and having ears hear not; but in the end could keep the benefit while repudiating the corrupt means by which it was attained.

In this very case the Bank, as well as McKnight, wanted his bond renewed. It could not get the bond renewed without a statement by its cashier to the effect that McKnight's accounts and moneys were correct, and that he had performed his duties in an acceptable and satisfactory manner, and that no reason was known why the guarantee bond should not be continued. The letter was addresed to the Bank; the Cashier responded and made the statement necessary to enable the Bank to get what it wanted. It got the benefit of the Cashier's letter, and is now contending that he had no authority to write the letter. The Bank was paying for the bond. That is the custom now with the banks. The Vice-President (R. 33), on behalf of the Bank, was taking an interest in getting a renewal in 1895, and the Cashier was doing this for the Bank in 1896. It is admitted that we were deceived by the letter of the Cashier; that but for that fraud we would not have executed the bond. In conscience and in law the Bank can not hold the advantage while repudiating the false statement made by the only agent that could conduct its correspondence.

In Thompson's Commentaries on the Law of Corporations, Sec. 4783, it is said:

> "The settled law that a principal is answerable where he has received a benefit from the fraud of his agent, acting within the scope of his authority, seems equally applicable to corporations and individuals. But where the agent has made the false representation in the line of his duty, and under circumstances which authorized the party seeking the information to regard it as the information of the corporation, it is quite unnecessary to the liability of the corporation that it should have received any benefit from it."

The renewal of this bond was the business of the bank; as much so as any other business it had. This answer of the cashier to our inquiry was made in the regular course of business, and came strictly "within the customary or ordinary duties of a cashier." He was not acting "outside of his ordinary duties." On the contrary, he was acting "within the scope of his agency." We have shown that there was no collusion between the Cashier and the President, and that the Cashier informed his father, the Vice-President and director, of every thing that went on at the Bank, and that the father, during 1896, was not friendly to McKnight. As the Bank ratified the act of the Cashier in writing that letter for the purpose of continuing the bond from June 1, 1896, to June 1, 1897, and as we renewed the bond on the faith of his letter of May 29, 1896, and as we would not have renewed the bond but for that letter, the Bank can not hold the benefit of the renewal bond without ratifying and approving the act of the Cashier in writing the letter.

In Morse on Banks and Banking, Sec. 162, it is said that "the Cashier has charge of the correspondence of the bank," and that "letters on corporate business are properly addressed to him, and whatever statements or information are contained in them will, in law, affect the bank with notice." See Sec. 165 (*b*); Section 171 (*d*). In Section 98 (*c*) the same author says that "whether at common law or under such statutory enactments, they (the directors) seek to curtail the ordinary powers of any of their officers, their action in so doing can only be valid as between the officer and the bank."

In Sec. 166 it is said:

> "Notice to the cashier that stock pledged is trust property is notice to the bank. . . . Sec. 152. The cashier is the chief executive officer through whom the whole financial operations of the bank are conducted. . . . The keynote to the whole subject lies in this: That the office of the cashier is strictly executive. . . . He is properly the executive agent of the directors. . . . Sec. 153. There are certain functions which by long and univer-al usage have come to be recognized as belonging to the office of cashier, and have been judicially ascertained and declared to be inherent in the cashier as matter of law, and without any vote of the directors or provision of the organic law."

Thompson on Corporations, Sec. 4740:

> "He (the cashier) is a statutory officer, not of the directory, but of the corporation. . . . Though chosen by the directors, he is as much the statutory agent of the corporation as the directors themselves."

In Boone on the Law of Banking, Sec. 115, it is said: "The cashier is also the agent of the bank for the purpose of writing and receiving letters on the subject of its ordinary business. A letter from him on the business of his bank is a letter from his bank, and a letter to him relating to the business of his bank is a letter to this bank; and the bank is chargeable with knowledge of the contents of such letter.

In Thomas v. Wells, 140 Mass. 517, it was held that where a letter was written to a firm and it was answered on the letterhead of the firm by an agent who ordinarily did not conduct the correspondence of the firm, the letter was nevertheless admissible against the firm, the Court saying:

> "It was written upon the business paper of defendant's firm, and was in answer to a letter sent two days before by the plaintiffs to the defendants, to which plaintiff required an answer and to which no other answer was returned. Upon this evidence it was not a violent inference for the jury to draw that the plaintiff's letter had been handed for an answer to Wells, the salesman who had made the contract with the plaintiff and knew what its terms were."

See Morse v. Conn. River R. Co., 6 Gray, 450; McGenness v. Adriatic Mills, 116 Mass. 177.

In McGee v. The Manhattan Life Insurance Company, 92 U. S., page 93, the Supreme Court held that, though a surety might not be released where he did not ask for information, he would be released when he asked for information and was not given a true answer, the Court saying: "If the surety desires information, he must ask it. . . . If the creditor be applied to, he must make a full and frank communication." (See Brandt on Suretyship and Guar. (Ed. 1891), Secs. 421, 422, 423.)

In Merchants Bank v. The State Bank, 10 Wallace, 604, it was held:

> "Where a party deals with a corporation in good faith—the transaction is not *ultra vires*—and he is unaware of any defect of authority or other irregularity on the part of those acting for the corporation, and there is nothing to excite suspicion of such defect or irregularity, the corporation is bound by the contract, although such defect or irregularity in fact exists."

In Xenia Bank v. Stewart, 114 U. S. 224, the Court said:

> "The letter was written on the paper of the Bank and by the person shown to be its cashier, and it appears with reasonable certainty to have referred to the business of the Bank. The Court was, therefore, right in not excluding it from the jury."

See Case v. The Bank, 100 U. S. 446–454; Martin v. Webb, 110 U S. 7; Badger v. Bank of Cumberland, 26 Maine, 428; Coldwell v. National Mohawk Bank, 64 Barbour, 333; Birmingham Trust & S. Co. v. Louisville Bank, 20 Law Rep. Ann. 600.

Morse on Banks and Banking, Section 103, says:

> "Where the officer of the Bank knows that his answer to the inquiry (for information) is to form the ground of future action on the part of the inquirer, so that accurate information is not merely desired to satisfy a curiosity as to an occurrence wholly in the past, but is sought and needed for governing important dealings in the present and future—there the Bank is bound."

In the Pauly case, Justice Harlan, in the opinion, cites the case of Bennett v. Judson, 21 N. Y. 238, as follows:

"In Bennett v. Judson, which was the case of an agent of the vendor of land who made material misrepresentations as to its location and qualities, assuming to have knowledge of the facts, but without express authority from his principal, the Court said: 'There is no evidence that the defendant authorized or knew of the alleged fraud committed by his agent Davis in negotiating the exchange of land. Nevertheless, he can not enjoy the fruits of the bargain without adopting all of the instrumentalities employed by the agent in bringing it to a consummation. If an agent defraud the person with whom he is dealing, the principal, not having authorized or participated in the wrong, may, no doubt, rescind, when he discovers the fraud, on the terms of making complete restitution; but so long as he retains the benefit of the dealing he can not claim immunity on the ground that the fraud was committed by his agent and not by himself. This is elementary doctrine, and it disposes of one of the questions raised at the trial.'"

As the lower court in the McKnight case excluded this letter of Cashier Reutlinger to the surety, and as a majority of the Judges of the Circuit Court of Appeals approved this action solely because they thought they were constrained to do so by the ruling in the American Surety Company v. Pauly, it may be well to note the marked difference between that case and this. In the suit on the O'Brien bond, it appeared that President Collins simply gave a certificate of good character to O'Brien when the latter was first applying for a bond. That was merely the answer of an individual to whom, as a friend of O'Brien an inquiry had been addressed; that was no part of the business of the President of the Bank. It is not the business of a President to conduct the correspondence of the Bank, and the letter of inquiry was not addressed to the Bank. In the McKnight case the letter was addressed to the Bank itself, and it called, not for a letter of recommendation, but for a frank, fair statement as to certain facts known to the Bank or its Cashier. That letter of the surety could be answered only by the Cashier. McKnight himself could not answer it, and the Board of Directors could speak only through the Cashier; and, as we have shown, by law and by custom, the cashier is the proper one to answer all correspondence. In the O'Brien case it was a question

merely of character; and the surety and the Bank had had no dealings together before. In the McKnight case there was no longer any mere question of character, but a question of fact, namely, whether McKnight had performed his duties during the past year in an honest and satisfactory manner. That was a matter that concerned the Bank itself, and about which there could be no doubt, and as to which the surety was entitled to a frank and correct answer. In the opinion in the Pauly case Justice Harlan lays stress upon the fact that President Collins' answers were merely commendations of a man who had not yet given a bond to the Bank with that surety, the Court saying: "No relations existed between the Bank and the Surety Company until O'Brien presented to the former the bond in suit."

Moreover, in the Pauly case the bond or contract did not provide that "the statement" of the president, on which the bond was obtained, was and should be held to be the basis of the bond. In the McKnight bond it was provided thus: "And, whereas, the said employer has delivered to the Company a certain statement, and it being agreed and understood that such statement constitutes an essential part of the contract hereinafter expressed." Further, the renewal contracts, by their terms, were "subject to all the covenants and conditions set forth and expressed in the bond of this Company No. 5002, heretofore issued on the first day of June, 1894." The renewal contract of June 1, 1896, on which we have been held liable for these defaults, was executed on the faith of the Cashier's excluded letter of May 15, 1896. That letter was "the statement" which "constitutes an essential part of the contract" on which we are held bound. By our contract we had a right to rely, not merely on "the statement" given us when the original bond was execu ed, June 1, 1894, but we also had a right to rely on "the statement" of the Cashier by which each renewal was obtained, for each renewal contract was, by its terms, "subject to all covenants and conditions set forth or expressed in the bond," etc.

In the Guarantee Co. v. Mechanics Savings Bank the teller's

bond as to this matter was word for word the same as our bond. The Guarantee Company's renewals were made in exactly the same way and on exactly the same terms as ours. In both cases the renewals were obtained on a certificate or statement of the Cashier in almost exactly the same words, as appears from this Court's opinion and the statement of the case. In the Guarantee case it is said:

> "This bond was renewed each year up to January, 1893, and in each year, before the bond was renewed, the Company furnished the bank with a blank form to be filled out, and stating: 'It is necessary before the bond can be renewed that you obtain the certificate on the back hereof by your president or cashier, and on its return, with remittance of the premium, the renewal can be effected.' The certificate on the back was filled up and signed BY THE CASHIER, and, among other things, stated that the accounts of said teller, Schardt, had been examined and verified by the finance committee of said bank; and the bond was not renewed in any year until this certificate had been made out and delivered to the Company."

That describes exactly what was done in our case except that the language of the Cashier's certificate in our case was stronger. This Court did not seem to have the slightest doubt that the cashier's certificate bound the bank in the Schardt case, and the Cashier's certificate in the McKnight case also should bind the Bank. As one of the judges of the Circuit Court of Appeals believed, a fatal error was made in excluding that letter or certificate of the Cashier. The true meaning of the Pauly case, which was based on its own peculiar facts, should now be made clear. In that case the statement of the president was the statement of a mere individual, and did not bind the bank because of his lack of authority, and because it was not agreed in the bond that "the statement" should be the basis of the bond, nor was said statement referred to and adopted in the bond.

FIFTH POINT.

The knowledge of Vice-President Reutlinger and Cashier Reutlinger of McKnight's defaults bound the Bank, but we understand the decision of the lower court not only to nullify the rule that the knowledge of such officers acquired in due course of business is the knowledge of the Bank, but also to be in direct conflict with the case of the Guarantee Company of North America v. the Mechanics Savings Bank and Trust Company decided by this Court January 6, 1902.

In this case the Vice-President, who was also a director, was not a mere figurehead. He was paid a salary of $1,500.00 per year (R. 38) for constant attendance in the Bank with active duties to perform. His desk was in the Bank (R. 40), where he could see and hear all important transactions. "He frequently examined the books of the Bank and kept the run of the Bank and what notes were discounted by the Bank and what overdrafts existed." "He sometimes acted as cashier and teller for his son." He was "familiar with the management of the German National Bank during all the time Mr. McKnight was there." He was (R. 38) "custodian of the Bank's cash reserve of many thousands of dollars." "It was the custom of the Cashier (R. 38) to tell his father, the Vice-President, all that went on at the Bank, etc." There was no collusion between the Vice-President or Cashier and McKnight, because "the feeling between Adolph Reutlinger, the Vice-President, and McKnight (R. 38) was not friendly during the year 1896." On March 11, 1895, he wrote a letter to the Fidelity & Deposit Company about McKnight's bond (R. 33), but this letter was excluded by the court from the jury. Evidently this was an active officer of the Bank.

The circumstantial evidence already set out shows that the Vice-President knew all about the Edmunds check for $1,000.00 and the Britt and Reeder loan of $2,000.00 except as to the exact contents of the two corrupt pledges and the names signed to them. He certainly knew there was gross fraud, if not political corruption,

in these deals; and that was enough for him to know. As the Bill of Exception shows (R. 37), he often had conversations with Edmunds, the political boss, during the heat of the canvass, at the Bank, which was evidently the political headquarters, and "*knew the purposes of his visits.*" As to the Britt and Reeder loan, he knew all that any man of sense needed to know to understand that a fraudulent political deal was being carried out with $2,000.00 of the Bank's money. The knowledge of an active Vice-President, who was a director, when the President was perpetrating frauds and when there was no collusion, ought to be considered the knowledge of the Bank when outsiders are concerned; and all the authorities cited and the reasoning applied in the American Surety Company v. Pauly are consonant with that principle.

The proof of the Cashier's guilty knowledge is equally complete; but we understand, and we believe the jury understood, the Court's instructions to say in substance:

(1) That the Cashier did not have knowledge of any fraud or default;

(2) That if he did have such knowledge, he did not get it in due course of business (though all he learned was learned while he was at work on the Bank's business in the Bank itself);

(3) That if he did have such knowledge, it made no difference in law, because his knowledge is not the Bank's knowledge.

The circuit court told the jury in substance that notice to the Cashier of McKnight's defaults was not notice to the Bank, and yet when we, in complaining of this erroneous charge, say that the Cashier did have such notice, and that the jury, if correctly instructed, would have so found, we are answered by the Circuit Court of Appeals with the statement that the jury found by their verdict that there was no notice. The Fifth Instruction of the Court (R. 59, 60), in effect told the jury that if the Bank (as distinguished from its cashier or any directors) knew of the defaults of McKnight and agreed to them, or if the Bank (mean-

ing its Board of Directors) knew of his defaults and condoned them, the Surety would be released; but the Court told the jury that McKnight's almost daily overdrafts did not of themselves constitute defaults, the condoning of which would release the Surety. The Court also said:

"Now, I suppose in this case, if *the Bank* had known that McKnight was making these drafts for these various fraudulent purposes, such as buying up Councilmen, buying up Aldermen, paying his own private personal debts; if *the Bank* had known that and consented to it, there would not have been a fraudulent act by McKnight for which the Bank could recover against this Company. But if you believe from the evidence that *the Bank* did not know of the fraudulent purposes for which these overdrafts were made, if the overdrafts were made in connection with this matter—if you believe *the Bank* did not know the fraudulent purposes, then that changes the result; because if the Bank did not know and still consented to it, it would not relieve the act of McKnight from the character of being a fraudulent act. So that, as I view this case—you must remember, however, that you are the sole judges of the evidence in this case, its credibility—as I view this case, however, there would be no fraudulent acts upon McKnight's part, limiting my observations now to the overdrafts, there would be no fraudulent act upon his part merely in an overdraft, if there were no fraudulent intent behind it, which was concealed from the Bank." . . . The defendant excepted because "The foregoing instructions did not submit correctly to the jury consideration of knowledge on the part of the officers or directors of the Bank, other than McKnight, which they had or would have had if customary supervision had been exercised."

In the foregoing charge the Court, by the constant repetition of the words "the Bank," evidently meant to tell the jury, and the jury understood the Court to mean, that no notice could be imputed to the Bank which was not made directly to the Board of Directors in their meetings. The Court might not have intended to go quite so far, but the jury must have thought, from the language of the Court, that neither the knowledge of the Cashier, nor the knowledge of the Vice-President, nor the knowledge of any or all of the directors individually, outside of the meetings of the Board, would release the Surety. The Court

also, in that language, in effect, told the jury that, if the Board of Directors, as a board, knew of McKnight's defaults and agreed to them, they were not defaults, and, therefore, we could not be bound; that, if the Board of Directors did not know of the defaults, then we were bound. In other words, the jury must have understood that we were bound, unless the Board of Directors had a formal notice of McKnight's actions and condoned them.

The sixth instruction of the Court brings out more sharply the Court's intention to tell the jury that the knowledge of a cashier gotten in the course of business in the bank is not the knowledge of the bank.

The Court said:

> "I do not think that the knowledge of a cashier of a bank, speaking generally, if [is] the knowledge of the bank as to any matter that does not come within the customary or ordinary duties of a cashier or those which have been specially imposed upon him by the action of the bank. I do not think Mr. R. E. Reutlinger in this case, in respect to any matter which he knew or could do, represented the bank, if it was outside of his ordinary duties; and I do not recall any thing that he knew, so far as the proof shows, that would in any wise affect the liability of the defendant in this case.
>
> "The defendant objected to the foregoing portion of the charge on the ground that the knowledge of the cashier of the acts of McKnight in respect to his overdrafts and his transactions with Britt and Reeder, and with Edmunds and Sachs, etc, was the knowledge of the bank."

The sixth instruction practically told the jury that all the cashier knew about McKnight's giving Edmunds those ten one-hundred-dollar bills during the Mayor's race before the General Council, and about McKnight's keeping the Bank open until six o'clock to give Britt and Reeder $2,000.00 of the Bank's money without interest for one year and without security, and about his paying Sachs for his private indebtedness with the Bank's money, and about the innumerable and large overdrafts, was information gotten by the cashier outside of the performance of his duty as a

cashier; that such knowledge of the cashier did not "come within the customary and ordinary duties of a cashier or those which have been especially imposed upon him by the action of the Bank"—that what the cashier learned about those transactions of McKnight's "was outside of his ordinary duties." And yet the cashier learned nothing, so far as the proof showed, outside of the Bank or when not discharging the duties of his office. *Every thing he learned about McKnight, so far as the proof shows, was learned by the cashier in the discharge of his duties—in the ordinary and customary discharge of his duties.* The cashier did not learn of these matters about McKnight merely from rumors or gossip on the street or in some other corporation in which they were directors or officers. On the contrary, the cashier learned of all these defaults of McKnight while he, the cashier, was paying money of the bank, as cashier and teller, to Edmunds; while he, as cashier, was keeping the bank open until six o'clock to give the money of the bank without security and without interest to Britt and Reeder; while he, as cashier, was paying the checks of McKnight that were creating those daily and large overdrafts; while he was holding up in his drawer, as cash items, for several weeks—almost for two months—checks of McKnight that could not be paid because McKnight had no money in the bank, and which should not have been held up as cash at all. The cashier knew that McKnight had no right to ask such favors, and that he, the cashier, as Judge Story said in Minor v. Mechanics Bank of Alexandria, 1 Peters, 46, had no right to grant them. In this case, we have not been able to prove any knowledge of the cashier which was not gotten in the bank itself, while he was discharging his duties.

We feel sure that the jury believed that the cashier knew very well at the time that the $1,000.00 given to Edmunds, the political henchman of McKnight in the race before the Council, in ten one-hundred-dollar bills which the cashier had to get from another bank was to be used in that race. The race was a matter of general notoriety, as appears from the bill of exception

Every intelligent man in the city of Louisville knew of it because the papers were full of it, and the proof shows that the cashier and his father knew why Edmunds was coming to the Bank, and why the other political workers of McKnight were coming there during that heated controversy. The jury must have believed also that the cashier knew well what the Britt and Reeder transaction meant. If he had not understood it well, he would not have run to his father's house at nine o'clock in the evening to tell it to his father, who was not friendly to McKnight. It is impossible to think that a cashier would believe the Britt and Reeder transaction was an ordinary bank transaction, the Bank being kept open until six o'clock to carry it out, and $2,000.00 of the Bank's money being lent for a year without interest and without discount and without security to two politicians of the General Council before which McKnight had been a candidate a few weeks earlier, and with whom and "the gang" he was still having meetings in the Bank building. It will be remembered that McKnight, when he asked the cashier to remain, told him that "he had a big scheme on hand," and next morning McKnight told the Vice-President in the Bank, when he showed the yellow envelope, that "those fellows had signed a paper," and that "he would not have signed it for the city of Louisville." The son had told the father the evening before who "those fellows" were and how they had gotten $2,000.00 before signing that corrupt paper. Director Reisch says he knew all about it three days later; that the Vice-President told him.

Whatever the jury might have believed on these subjects—though they might have been morally certain that the cashier knew all about these corrupt transactions—still they must have thought from the instructions of the Court that the knowledge of the cashier of these defaults and this corruption could not excuse the Surety under the instructions of the Court. Indeed, it is *impossible* that the jury could have otherwise understood the charge of the Judge, because he distinctly told them: "I do not recall *anything* that he knew, so far as the proof shows, *that would*

in anywise affect the liability of the defendant in this case." The jury hung a long time, and they were not brought to agreement on a verdict until after the Court gave them an additional, and, as we believe, a misleading instruction, No. 8.

It becomes highly important, therefore, to determine whether the knowledge of a cashier, gotten while he is transacting the business of the bank in the bank, is the knowledge of the bank. The quotations from Mechem, Story, Morse, Boone, and Thompson show that the text-writers approve the principle for which we contend, and the decisions of the courts, with few exceptions, are in the same line.

The National Banking Act (Section 5136, Sub-section 7) authorizes a National Bank to exercise its powers "by its board of directors, or duly authorized officers or agents." As said in Boone on the Law of Banking, Section 103, "the cashier of an incorporated bank is the general executive officer to manage its affairs in all things not peculiarly committed to the directors, and he is *the agent of the corporation, and not of the directors.* As such executive officer he transacts most of the business of the bank. He is held out to the world by the bank as its general agent for the transaction of its affairs, within the scope of the general usage, practice and course of business of banking institutions; and his acts within such scope of authority will in general bind the bank in favor of third persons possessing no other knowledge. *The directors may limit his authority as they deem proper, but this would not affect those to whom the limitation was unknown."*

For many purposes the cashier, as much as the board of directors, is the agent of the bank.

In Thompson's Com. on the Law of Corporations, Section 4740, it is said:

> "A cashier of an incorporated bank is regarded in law as its general executive officer. He is in no sense the agent of the Board of Directors. He is a statutory officer, not of the directory but of the corporation. . . . Though chosen by the directors, he is as much the statutory agent of the corporation as the directors themselves."

In Mechem on Agency, Section 718 (Ed. 1888), it is said that a notice to, or the knowledge of, an agent like a cashier, is the knowledge of the corporation, except (1) when it is the duty of the agent (like a lawyer or a priest) not to disclose what he knows, or (2) when the agent is really acting in his own interest or in another's interest, and adversely to the principal, and where there is collusion, and (3) when the person claiming the benefit of the notice was in collusion with the agent to cheat or defraud his principal. None of those exceptions apply in this case.

See Story on Agency, Section 140 (*b*), Thompson on Corporations, Section 5224; Morse on Banks and Banking, Section 152-3, 166, Section 153 of which says:

> "There are certain functions which, by long and universal usage, have come to be recognized as belonging to the office of the cashier, and have been judicially ascertained and declared to be inherent in the cashier as matter of law and without any vote of the directors or provision of the organic law."

In the Distilled Spirits, 11 Wallace, 356, the Supreme Court held that the knowledge of an agent who bought the distilled spirits that they had been removed from the warehouse by fraud, was the knowledge of his principal.

In Biswell v. First National Bank of Franklin, 69 Pa. St. 415, it was held that the cashier is the agent of the corporation, not of the directors; that what he knows the bank knows, even though he should not communicate the knowledge to the board of directors. That case is exactly in line with the opinion of Judge Story in Minor v. The Mechanics Bank of Alexandria, 1 Peter, 46, in which case it was held that the cashier, in some respects, is as much the representatives of the bank as the Board of Directors, and that he can not excuse himself for improper practices even by showing an order from the board; that he is not merely the helpless creature of the board, but is the agent of the bank itself; that he can not blindly do improper things on the order of the board, much less on the order of the President.

In the Birmingham Trust and Savings Company v. The Louisiana Bank, 99 Ala. 379 (1893), it was held that the cashier's knowledge of a pledge was the knowledge of the bank, the Court saying:

> "Otherwise knowledge or notice could never be traced to the corporation, and the utmost insecurity in dealing with it would follow. And upon general principles of public policy it is and must be presumed that the agent communicates to the principal the facts of which he acquires knowledge or notice. If the communication is not made, it is the fault or neglect of the agent, which must be visited on the principal, rather than upon strangers dealing with the agent, within the scope of the agency."

To the same effect are Potter v. The Bank of Rutland, 19 Ver. 410; Central National Bank v. Levin, 6 Mo. App. 543; Holden v. The New York & Erie Bank, 72 N. Y. 286 (1878); Duncan v. Jaudon, 15 Wallace, 165.

In Veasy v. Graham, 17 Ga. 99, the president and cashier of a bank made a deed to the president of the bank's property, and this deed was set aside, the court saying:

> "The cashier had actual notice of the fact, because he aided in executing his title. To whom else should notice have been given? The stockholders or the directors or both? We know of no such practice."

In A. C. Freeman's exhaustive notes to the case of the Bank of Pittsburg v. Whitehead, 36 Am. Dec. 186 (10 Watts, 396), it is said that "a corporation must be held to know what its president and general officers know;" that what is known to the president and cashier is known to the bank; that "the cashier of a bank is its general agent, managing all its concerns, except such as are committed directly to the bank directors." To the same effect are the cases of New Hope Delaware Bridge v. Phoenix Bank, 3 New York, 156; McGurk v. Metropolitan Life Insurance Company, 1 Law Rep. Ann. 563, or 56 Conn. 528; Bank of America v. McNeal, 10 Bush (Ky.), 54; Cook on Corporations, Sec. 727; Thomson-Huston E. Co. v. The Capitol

Electric Company, 65 Fed. Rep. 341; Wilson v. Pauly, 77 Fed. Rep. 129.

In Mechanics' Bank v. Gilmartin, 93 Ga. 504, it was held, on circumstantial evidence, as in our case, that the president of the bank, who knew that the cashier was speculating and saw him in consultation occasionally with brokers and learned casually from them that he was dabbling in stocks, must be presumed to have sufficient knowledge to put him on inquiry, and his knowledge was imputed to the bank, and the bank was held liable for the bonds fraudulently converted by the cashier.

The rule we are contending for is not at all modified or impaired by the decision in the case of the American Surety Company v. Pauly, 170 U. S. 559, in which the Supreme Court recognized the soundness and the binding force of the foregoing authorities, and admitted that the general rule was the one for which we are contending. In that case the Supreme Court quotes with approval the charge of the lower court to this effect:

> "Ordinarily a corporation, like any other principal, is chargeable with the knowledge of any facts which are known to its agent, but in this case all the transactions, if there were any transactions of a fraudulent and dishonest character on the part of the cashier, were transactions for the benefit of Collins, and he was a participator in the fraud, and under these circumstances the law does not infer that the agent or the officer will communicate the fact to his principal, the corporation."

Justice Harlan, in rendering the opinion of the Supreme Court, held that, as President Collins and Cashier O'Brien were in collusion to defraud the bank, the knowledge of neither one could be imputed to the bank. because it could not be presumed that they would tell the board of directors that both of them were defrauding the bank. The Supreme Court said:

> "The presumption that the agent informed his principal of that which his duty and the interests of his principal required him to communicate does not arise where the agent acts or makes declarations not in execution of any duty that he owes to the principal, nor within any authority possessed by him, but to subserve simply his own personal ends, or to

commit some fraud against the principal. In such cases the principal is not bound by the acts or declarations of the agent unless it be proved that he had at the time actual notice of them, or, having received notice of them, failed to disavow what was assumed to be said and done in his behalf."

The Supreme Court then quotes a large number of authorities, all holding in substance that when the agent is himself trying to defraud his principal it will not be presumed that he communicates to his principal the knowledge he has, or that he tells the principal just how he is trying to defraud the principal; and then the Supreme Court continues:

"Further citation of authorities would seem to be unnecessary to support the proposition that, if Collins gave the certificate that he might, with the aid of O'Brien as cashier, carry out his purpose to defraud the Bank for his personal benefit, the law will not presume that he communicated to the bank what he had done in order to promote the scheme devised by him in hostility to its interests. In our judgment the Circuit Court of Appeals correctly held that plaintiff's right of action on the bond was not lost because its president, Collins, made to the defendants false representations as to the cashier's honesty; and that, when two officers of a corporation have entered into a scheme to purloin its money for the benefit of one of them, in pursuance of which scheme it becomes necessary to make false representations to a third person, ostensibly for the bank, but in reality to consummate such scheme, and for the benefit of the conspirators, and not in the line of the ordinary authority, the corporation being ignorant of the fraud, the officers are not, in thus consummating such theft, the agents of the corporation."

This was the principle on which the Court rested its opinion, and in so doing it laid down the law exactly as it is stated in Mechem on Agency, Sec. 718, a section which we have heretofore quoted. Mechem says there are only three exceptions to the rule that the knowledge of the agent will be imputed to the principal, and those three exceptions are the following:

"(1) Where it is such as it is the agent's duty not to disclose (as where he gets confidential knowledge as an attorney, priest, etc.), and,

"(2) Where the agent's relation to the subject-matter or his previous conduct render it certain that he will not disclose it (as where he is trying to carry out or aid another in carrying out a fraudulent scheme, such as Collins and O'Brien were carrying out), and,

"(3) Where the person claiming the benefit of the notice, or those whom he represents, colluded with the agent to cheat or defraud the principal."

In the McKnight case the Cashier was not acting in collusion with the President. There is no pretense that the Cashier was purposely trying to assist McKnight in defrauding the Bank. The proof showed that the feeling between McKnight and the Vice-President was unfriendly, and that the Cashier, on the night of the Britt and Reeder transaction, went as late as nine o'clock in the evening to the Vice-President's house to notify the Vice-President, who was a director, that McKnight, whom he disliked, had carried out that corrupt deal with Britt and Reeder. Hence it appears that the case of the American Surety Company v. Pauly is a direct authority in favor of the petitioner, and is in line with the text-books and cases cited and relied on in this brief.

But in the latest case in this Court, in the case of the Guarantee Company of North America v. the Mechanics Savings Bank and Trust Company, decided January 6, 1902, this Court practically decided our case beyond controversy. In that case this Court held that the information given by Kyle and the anonymous letter sent to the cashier, informing him of Schardt's speculations, later communicated to the president and to one or two of the directors, gave the bank all the information or knowledge it needed, and the bank was bound by this knowledge and the surety was released because the bank did not communicate that knowledge to the surety. What the president and cashier knew in that case was not more than was known to the Vice-President and cashier and Director Reisch in our case. Schardt denied that he was speculating, as McKnight tried to explain away the Britt and Reeder note; but in each case the excuse was flimsy, and, at any rate, the surety in each case had a right to know the facts,

and to decide for itself, as this Court held. The facts showing McKnight's frauds, and showing that the Vice-President and cashier and Director Reisch had personal knowledge of them, were stronger and clearer than the facts from which knowledge was imputed to the Mechanics Savings Bank and Trust Company from the information gotten by the cashier and president of that bank. Diligence and good faith were not used by the banks in either case, and this surety should be released, as that one was by this Court.

It will be contended that the contract of the Guarantee Company of North America differed from our contract; but the difference is only in non-essentials. The teller's bond in the Guarantee Company's case (and the decision turned upon that bond and the defaults and the notice due to the surety under it) is, in all essentials, exactly like the bond in this case. The defaults under the teller's bond amounted to $50,649.90 up to January 1, 1893, the date of the cashier's bond; and, though the bank got information of Schardt's speculations "in the summer or fall of 1892," the surety was held not liable even on the teller's bond.

The provision in the two bonds as to "due and customary supervision" over the employe for the prevention of default, and as to the effect of condoning the default without notice to the surety, is identically the same. Exactly alike, too, are the provisions of the two bonds as to the inspection or audit of the accounts of the employer. Practically the same are the provisions of the two bonds as to "immediate notice" of the discovery of any default, and both bonds have also this clause:

> "That the employer shall at once notify the Company on his becoming aware of the said employe being engaged in speculation or gambling or indulging in any disreputable or unlawful habits or pursuits."

In the Guarantee Company's case this Court has said that information which might be sufficient to make the employer "aware of" the employe's speculating or disreputable habits might not be

sufficient to show "knowledge." In McKnight's corrupt political trickery at the Bank, with its money, through his henchman Edmunds, he was "indulging in disreputable or unlawful habits or pursuits"; and there was certainly evidence enough to show that Vice-President and Director Reutlinger and Cashier Reutlinger and Director Reisch were "aware of" that corruption. Reisch admitted *that he knew of the corrupt purchase of Britt and Reeder* and says that Vice-President and Director Reutlinger told him of it three days after the deal. Schardt's purchase of an interest in a bucket-shop in Nashville was not more "disreputable or unlawful" than McKnight's buying councilmen and aldermen in Louisville. The officers and directors of the Mechanics Savings Bank had not more proof to make them "aware of" Schardt's guilt than the two Reutlingers and Reisch had of McKnight's guilt. The two cases must go together. They can be separated or distinguished only by quibbling.

The Court of Appeals of Kentucky in the Germania Safety Vault & Trust Co. v. Driscoll decided, on February 6, 1902, that, as the same McKnight was President of the German National Bank and also President of the Germania Safety Vault & Trust Co., and as he, as President of the Bank, knew of its insolvency, his knowledge was the knowledge of the Trust Company, and therefore the Trust Company, because of its negligence, was liable for the loss of a trust fund deposited by it in the Bank. The Court of Appeals so held because the President of the Trust Company, McKnight, "had actual knowledge at the time of the insolvent condition of the Bank, and its officers whose duty it was to look after deposits of trust accounts had heard rumors sufficient to put them on inquiry, which, if made, would have revealed to them the true condition of the Bank."

Evidently the Court of Appeals of Kentucky would have exonerated the surety on the same ground.

SIXTH POINT.

The knowledge of Director Reutlinger and Director Reisch of McKnight's defaults bound the Bank, but we understand the decision of the lower court to nullify the rule that the knowledge of a director acquired in the business of the bank is the knowledge of the bank and to be in direct conflict with the decision of this Court in the Guarantee Company of North America v. The Mechanics Savings Bank and Trust Company, decided by this Court January 6, 1902.

In this case the complainants have recovered judgment against the surety for several defaults, but the first in time was a payment of $1,000 by the cashier of the bank to S. E. Edmunds, the political manager of McKnight, in ten one-hundred-dollar bills on January 21, 1896, on the order of McKnight, who became a candidate for mayor of the city of Louisville before the General Council thereof a few days after the death of the Hon. Henry S. Tyler on January 14, 1896. With that $1,000.00 S. E. Edmunds bought four councilmen and got from them a written pledge to vote for McKnight. A race for mayor in a big city like Louisville filled the newspapers with exciting news of every possible description relative to the candidates, their history, business connections, their leaders and benchmen, and this race was of course a subject of profund interest and earnest discussion to everybody in the city, including, of course, the officers and directors and clerks of the Bank, whose President was a candidate. (R. 37.) A few days after January 14, 1896, McKnight became a candidate, and a few days after he became a candidate, to wit, January 18, 1896, he was overdrawn in bank $1,340 12. On January 20, 1896, he was overdrawn $1,460 14. On January 21, 1896, he told his Cashier to give his well-known political manager, Edmunds, who was in constant conferences about the election at the Bank itself, $1,000.00 in ten one-hundred dollar bills. (R. 35.) *He was particular to have ten bills of* $100.00 *each. Nothing else would do.* Such bills are very convenient for buying councilmen, but not especially desirable in ordinary transactions.

The Cashier, who was also teller, did not have ten bills of $100.00 each. McKnight sent him out to another bank on that peculiar mission, to get that special kind of money. The Vice-President, who was the father of the Cashier and a director (R. 36), heard the President send the Cashier and teller out to get the money in that strange way for the political boss whose headquarters seemed to be in the Bank during this exciting race; and the money was paid to the boss on his own check, when he had no money in bank and was himself in need. By the order of McKnight that check was held up by the Cashier as cash in his drawer from January 21, 1896, to March 12, 1896, seven weeks (R. 35); and then it was charged, not to to the man who got the money and who gave his individual check for it, but to S. E. Edmunds & Company, in which McKnight was a partner.

On that same 21st day of January, 1896, when McKnight was overdrawn in a large sum, he gave another check of $1,253.00 to some Louisville lawyers to pay a private claim against himself, and that check, too, at his request, was held up by the Cashier for seven weeks in his cash drawer as cash, and was not charged to anybody till March 12, 1896, and then it was charged to S. E. Edmunds & Company (R. 38). The Vice-President and director saw that this check also was being held up in this improper way by his son, and was told by the Cashier that this was being done by order of McKnight.

It can easily be understood why the officers and directors of a bank on the verge of bankruptcy might want its President to become mayor of the city and, by means of city deposits and political patronage, get the Bank a new lease on life, and why the officers in desperate straits might connive at corruption, if they did not directly aid in it, to secure his election, and why they might later conveniently forget or pretend to misunderstand the plainest features of the transaction.

A few days after McKnight's political manager had bought the four councilmen with the ten one-hundred-dollar bills, McKnight was beaten for Mayor by Mr. George D. Todd; and

there was great dissension between McKnight's gang and the successful candidate's supporters. McKnight, out of spite or because he hoped to get political patronage that would pay him and the bank, organized an opposition party; and, to block the measures of the successful mayor and to control municipal affairs, he needed seven of the twelve aldermen. He could count on five and must buy two more. Britt and Reeder were willing to sell. Edmunds was used to buy them. McKnight, on February 6, 1896, about two weeks after the purchase of the four councilmen, Jenne, Sowders, Glover, and Adams, and a few days after the election, told the Cashier and teller to keep the bank open that evening after banking hours; "that he had a big scheme on hand, and that it was a big thing" (R. 36), not that it was merely to lend a little money of the Bank in a legitimate way. At 6:30 P. M. Edmunds appeared at the Bank with two aldermen—Britt and Reeder, who had no property. Edmunds wrote out a note for $2,000.00, which was not to bear interest for a year—wrote it out in the presence of the Cashier and McKnight. But the money was not given to them at once. *They must first do something else upstairs, where "the gang" was, to get the money* (R. 37). They went upstairs over the bank, where "the gang," the other five aldermen, were waiting for them, and there they and the five other aldermen signed a written agreement to the effect that McKnight should be their political boss and that they would only vote after consulting him. *Meanwhile the Cashier was waiting for Britt and Reeder to come down for their money.* They came down, and then they were allowed to get their hands on the money, no interest being deducted in advance. Immediately, in the Bank, Edmunds demanded his part of the corruption fund, and they gave him $225.00.

At 9:30 o'clock that same evening the cashier ran to his father's house to tell him, the Vice-President and the Director, of this strange business. The next morning the Vice-President called for an explanation from the President. The President said the note was good, and that it *would* be guaranteed by two

sureties, whom he named, but they never did give the guaranty. He did not explain why $2,000 of the Bank's money was being lent for a year without interest. In the same conversation McKnight (R. 38), who "had a long yellow envelope in his hand" (containing, of course, the corrupt pledge), told the Vice-President that "those fellows (the Aldermen, known, of course, to the Vice-President and his son) had signed it, and that he would not sign that for the city of Louisville;" that "he had a meeting up stairs (while the Cashier was waiting, and of which, of course, he must have known) and that paper was signed, and he would not sign it for the city of Louisville." The language of the President could leave no doubt in any sane man's mind what he meant. To suppose that a man who had had sense enough to be President or Vice-President of a National Bank in a big city for about twenty years did not have sense enough to know that a corrupt deal had been made, and that a lot of rascals had signed an incriminating and disgraceful paper, would be unreasonable. Reisch said that the Vice-President understood it well.

The Vice-President testified that he was not satisfied with the explanation of the President; and, being really unfriendly to the President, he brought the matter before the Board and told them that he had examined into the condition of the two aldermen who had gotten two thousand dollars of the Bank's money under such suspicious and questionable circumstances, and that they had no property; that they were insolvent. McKnight then came before the Board of Directors and said that the note *would* be guaranteed by two sureties (who never did so); and that, if not, he (then heavily overdrawn and having the Cashier hold up checks for him to the amount of at least $2,253.00 as cash items in the cash drawer) would pay it himself. The directors, so child-like and bland, were satisfied. *Any thing satisfied them.* What this court said of Schardt's explanation in the Guarantee Company's case we may say of McKnight's explanation here: "How any thing but such a denial could be expected it is not easy to see, nor how careful and prudent men could have been justified in omitting independent inquiry."

All the foregoing circumstantial evidence was proven by the witnesses of the Receiver. No witnesses were called for the defendant. As to all these matters, there was no contrariety of evidence, excepting that the Cashier, to clear himself, said that he never understood what any of these queer things meant, and excepting that his father, the Vice-President, to clear himself, said that he never understood them; but one of the Receiver's witnesses, Director Reisch, honestly testified that the Vice-President did understand them; that the Vice-President, in the bank, when Reisch was discharging his duties as Director, told him, just after the Britt and Reeder transaction, just how the corruption was effected. Reisch, on direct examination by the Receiver's attorney, said:

> "No, sir; I just heard about it, about that Reeder note, about two days after, that Reeder went up that night in the bank and got $2,000.00 out, but that was about two or three days after that happened . . . Old man Reutlinger (Vice-President and Director) told me; he said the bank was open about six o'clock that night and *Britt and Reeder and the whole gang there*, he gave a note and got $2,000.00 out of the bank. . . . No, sir, I just heard after that it was for the Council race, the Todd race, something like that. . . . I heard that three days after the money was out of the bank. . . . *Q.* What was it you heard in three days after the money was out of the bank? *A.* That the bank was open after six o'clock and they got $2,000.00 out of the bank. . . . Old man Reutlinger (Vice-President) told me that. . . . That the money was used for the Mayor's race, for the Todd race. . . . *Q.* Are you certain that Mr. Reutlinger told you that? *A.* He told me, not in the director's meeting; he told me that outside. . . . *Q.* Were you not in the directors' meeting when that note was considered? *A.* Yes, sir, I believe that *that note did come up*, and McKnight said if Reeder did not pay it he would."

Vice-President Reutlinger denied this, but Director Reisch is borne out by circumstantial evidence and by the inherent probabilities. At any rate, beyond all dispute, one director, Mr. Reisch, from whatever source he got his information, knew of this corruption, and he knew it before the matter came before the board; and *the legal presumption is that he did his duty by telling the board what he knew.* Notice to him was notice to them.

The payment of that $1,000.00 to Edmunds and the payment of the $2,000.00 to Britt and Reeder were held by the circuit court and by the Circuit Court of Appeals, according to the terms of the bond, to be "acts or defaults on the part of the employe (McKnight) which would give (and did give) the employer (the bank) the right to claim" under the bond; and the bond provided that if the bank should "condone any such act or default," or should thereafter continne McKnight in its service without written notice to the surety, the bond company should not be responsible for any subsequent default. All the defaults for which the surety was held liable were these defaults and defaults that occurred later; and yet the Edmunds default and the Britt and Reeder default were clearly known at the time by the officers and several directors, and, we think, by the board itself; and those defaults were condoned; and, at any rate, the notice which was provided for in the bond was never given to the surety.

In spite of the foregoing fair statement of the evidence as it appears in the bill of exceptions, the circuit court, in the charge to the jury, said:

> "That none of them (the officers and directors of the bank) had any knowledge that any act of his (McKnight's), in the management of the said bank, was fraudulent or dishonest, until after the closing of the bank . . . That none of the officers of said bank, including the directory, had any knowledge of the various checks set up in the petition as fraudulent, etc."

The checks set up in the petition as fraudulent were the Edmunds check, the Britt and Reeder note, and the other checks that followed them, one of them being on the same date as the Edmunds check, and also held up for seven weeks as cash in the drawer. Every fraudulent act of McKnight described above he was able to do and did do "in the performance of the duties of his office or position." Every thing he did he was able to do by reason of his power as President, and every one of those acts was done in the Bank itself. His orders to the Cashier and his dealings with Edmunds were in the Bank itself; and Cashier

Reutlinger and his father, Vice-President, and Director Reutlinger, learned of all these things in the Bank, in due course of its business, and while they were respectively engaged in attending the business of the Bank.

The Court also told the jury positively that Cashier Reutlinger and Vice-President and Director Reutlinger did not understand the fraudulent nature of the Edmunds check for $1,000.00 or the Britt and Reeder note for $2,000.00. The Court also told the jury, in substance, that if the Cashier or Vice-President or any individual directors knew of these frauds and concealed them from the surety, the surety would still be liable unless "THE BANK," that is, the Board of Directors, as such, had knowledged of the frauds, practically had formal notice of them. The Court, in the 7th Instruction (Rec. 61), said:

> "The testimony in respect to the knowledge of THE BANK of the purpose for which the $2,000.00 was taken out at half past six or seven in the evening, I say the knowledge of THE BANK respecting that, must be proven, in my judgment, in such a way as to satisfy the jury that THE BANK, *as distinguished from any mere director of it, knew* of that transaction. . . . If you believe from the evidence that THE BANK did know of this fraudulent purpose, and that this default of McKnight's, this fraudulent act of McKnight's in getting this $2,000.00 was known to the Bank at the time, then I instruct you that all of the liability of the defendant in this case would cease then, that being the earliest, or one of the earliest, if not the earliest, of all these transactions. If you believe from the evidence that this transaction was known and condoned by THE BANK at the time, before these other transactions occurred, then the defendant in this case is not liable. But, if you believe on the contrary that THE BANK did not know it, that it was the fraudulent act of McKnight alone, not participated in by *the Bank—when I say the Bank, I mean the Bank, I do not mean any individual director*—then the defendant is liable. . . . The defendant objected to that portion of the charge because it declared that the knowledge of an individual director or directors of the acts of McKnight was not the knowledge of the Bank, and the jury should have been instructed that the knowledge of the Vice-President, who was a director, and of Mr. Reisch, a director, should be imparted to the Bank itself; but the court erroneously overruled the objection of defendant and let said instruction stand."

The jury must have understood this to mean that, even though they should differ from the court and should believe that Director Reutlinger and Director Reisch, and even other directors, did know of McKnight's frauds, still their knowledge was not the Bank's knowledge, and that only a formal action of the board of directors of the Bank or a formal notice to the board of directors could be said to prove the knowledge of the Bank. If that be sound law, it will be practically impossible ever to bring guilty knowledge home to "the Bank" itself or to the board of directors as a board; and yet the Circuit Court of Appeals, giving a similar quotation form the charge, says: "We think this instruction as favorable as the Company was entitled to." If this be a fair statement of the law, directors of a corporation who wanted to indulge in questionable or corrupt practices with impunity could and would always find it easy and expedient to keep their information and records in such shape that nobody could bring out proof of guilty knowledge on the part of the corporation or board of directors.

This very case illustrates the impossibility of proving corrupt actions in the way required by the Court. Here not a witness could defendant find or introduce to prove these bald, unmistakably corrupt transactions. All proof of them had to be extorted by cross-examination from unwilling witnesses, whose interest and wish it was undoubtedly to shield themselves from blame by saying that they did not understand what any boy of sixteen or any man of the dullest mind could have understood if he did not have a motive for refusing to understand. Let it be noted that all the incriminating circumstantial evidence against Vice-President Reutlinger, Cashier Reutlinger, and Director Reisch was admitted by them. Director Reisch admitted that he was told and, at any rate, thoroughly understood the corruption in the Britt and Reeder loan. Vice-President Reutlinger admits every thing, except that he denies that he saw or knew of the actual purchase of the four councilmen and the contents of their pledge or the contents of the corrupt pledge by the seven aldermen, including Britt and Reeder. He admits he knew every thing

else about those two transactions. So does the Cashier. Let us concede, for the sake of argument, that we had never been so lucky as to prove by cross-examination of complainant's own witnesses the actual payment of the Edmunds' $1,000 to the four councilmen and the contents of the written pledge, and the contents of the corrupt Britt and Reeder loan; let us concede that, and still there would be enough evidence to show knowledge of McKnight's guilt by Vice-President Reutlinger, Cashier Reutlinger, and Director Reisch. Vice-President and Director Reutlinger tells enough to show this, for he admits that he overheard McKnight's directions to the Cashier about the ten one-hundred-dollar bills, etc., and he admits that his son told him of the Britt and Reeder loan the same night, and that next morning he called McKnight to account, when the latter had in his hand the yellow envelope, and which he then showed Vice-President Reutlinger, saying (as appears in the Bill of Exceptions, R. 38) that "*those fellows* had signed it, and that he would not sign that for the city of Louisville;" that "he had a document there in his pocket which was signed by those fellows," "the gang," as Reisch called them; that "he had a meeting up stairs (as the Cashier knew the evening before), and that paper was signed, and he would not sign it for the city of Louisville." This conversation was had with him by the Vice-President when the Britt and Reeder matter was being discussed."

Even if Vice-President Reutlinger and Cashier Reutlinger and Director Reisch did not know the contents of those two corrupt pledges, or did not see the money paid, they at any rate knew enough to put them on inquiry—to make it their duty to investigate fully. When Vice-President Reutlinger, as he admits, began the investigation into the corrupt loan to Britt and Reeder, and reported it to the Board of Directors, it was his duty and the duty of the board to sift the matter to the bottom. As this Court said in the Guarantee Company's case:

> "It (the surety) had the right to investigate for itself whether the bank did so or not. Notification of the existence of reason for inquiry was exactly what the clause was

intended to secure. The bank neither investigated nor gave the Company notice of the information it had, and substituted its own judgment as to the value of that information for that of the Company. In our view this conduct on its part amounted to a breach of the stipulation."

The slightest investigation would have brought this corrupt matter to light. Political matters of that character, widely discussed in the newspapers, can not be concealed, and the officers and directors of the bank had enough information to enable them to probe the matter to the bottom. Edmunds, the political boss, and the aldermen and councilmen involved, could be easily investigated. The language of the Circuit Court of Appeals, fairly interpreted, practically lays down the doctrine that a bank or any other corporation can escape the duty of investigation and of exercising "due and customary supervision," and can escape the penalty of fraudulent action by merely pretending to be satisfied with a trivial investigation and flimsy pretenses, such as McKnight offered, and by not passing any resolution as a board, or by not allowing any record or communication to be made of matters well known to the directors and officers individually. When we said that the directors in this case knew the fraud in the Edmunds transaction, and in the Britt and Reeder transaction, we were answered with the statement that those were questions of fact which were found against us by the jury, but the jury were compelled to ignore the proof as to those facts, because they were told in the charge that the knowledge of the individual directors or of the officers made no difference—that such knowledge was not the knowledge of the Bank, and that we could escape only by proving notice to the Bank itself or its Board of Directors, apparently in formal session. The verdict of the jury can not be construed to mean that the jury believed that the officers and individual directors were ignorant of the fraudulent nature of the Edmunds check and the Britt and Reeder loan, because the jury were told, as a matter of law, that the knowledge of the Cashier and the Vice-President, or of the individual directors, was not the knowledge of the Bank, and could not exonerate the surety.

As Director Reisch admitted that he knew, two or three days after the Britt and Reeder loan, of the corrupt nature of that loan, the jury would have been compelled to find for the surety, if they had not been told that any knowledge of Reisch alone of that corrupt deal was not the knowledge of the Bank, and would not justify a verdict for the surety. Not a syllable of evidence was there to contradict the admission of Director Reisch that he knew of this matter, even though there might be a dispute as to who gave him the information—whether it was Vice-President Reutlinger or somebody else.

The Circuit Court of Appeals, in its opinion, says:

> "We must remember that this obligation was intended to secure the Bank against the fraudulent conduct of McKnight in the performance of the duties of his office or position; that McKnight's action, in order to require notice to the company, must have been 'of the discovery of any default or loss under the bond.' While McKnight MIGHT *have been guilty of reprehensible conduct*, it would not require notice unless such as might result in the loss of securities, or money, or personal property of the bank by fraudulent conduct in the performance of his duties to the bank."

This is very mild language for a court of justice to apply to McKnight's purchase of four councilmen and two aldermen, and his causing his private debts to be paid on his own checks when he was overdrawn in a large mount, and when he caused his checks to be held up as cash for seven weeks, and then had them charged to an improper account; but, waiving that mild censure of such conduct, it must be said that every act of McKnight's of which we complained was an act for which we were compelled to pay under our bond, because of his "fraudulent conduct in the performance of his duties to the Bank." Of all those acts so well understood we were entitled to notice at the time under the terms of our bond.

The Circuit Court of Appeals says further:

> "Misconduct which would not amount to a fraudulent act affecting the duties of the officer of the bank, would not require notice unless it came within that clause of the bond which requires the employer to notify the company

> when the employe engages in gambling or speculation, or indulges in disreputable or unlawful habits or pursuits. Whether McKnight's conduct was of this character, the court left the jury to determine. They must have found that there was no such misconduct as would avoid the bond while the bank was in operation, and which it was the duty of the bank to report to the company."

In the first place, all of McKnight's misconduct consisted in "fraudulent acts which affected his duties as an officer of the bank." In the next place, it could not be said that the jury "must have found that there was no such misconduct as would avoid the bond while the bank was in operation, and which it was the duty of the bank to report to the Company," for the simple reason that the charge of the court below practically told the jury that the fraudulent acts of McKnight were unknown to the officers of the Bank and to the Directors of the Bank, and that no matter how fraudulent his conduct might be, and no matter how well the Vice-President, the Cashier and Director Reisch might have known of his misconduct, we could not be exonerated unless "the Bank" itself, that is, the Board of Directors, had formal notice of his misconduct, or, in some unmistakable way, as a board, connived at his misdoings.

The Circuit Court of Appeals also says:

> "In this connection it is averred that the Court erred in saying that this knowledge must be the knowledge of the bank, intending thereby to exclude the knowledge of individual directors. In the charge above quoted, as to the knowledge of the bank directors, we have already said that we find no error. We have carefully examined the record and find no knowledge brought home to the directors individually or the cashier in his individual capacity which was not brought to the attention of the Board, which would amount to a default under this bond. Such knowledge, in order to be binding upon the bank, must have been acquired in the course of business of the bank by such officer or director."

In the first place, we have shown from the Bill of Exceptions that Mr. Reisch, a director, testified that Vice-President and Director Reutlinger in the Bank itself told him two or three days

after the Britt and Reeder loan that $2,000.00 had been gotten from the bank by two of the "gang," whom McKnight had at the bank at 6:30 P. M., and that it was used "for the council race, the Todd race, something like that." This would certainly "amount to a default under this bond." And nobody has ever pretended that this information was brought in this straight and direct form to the atttention of the Board itself; but as two directors had the information, the legal presumption is that they gave their information to the Board. If the admission of Director Reisch as to what he was told by Vice-President and Director Reutlinger is not sufficient to show that these two directors knew of the corrupt use for which the Britt and Reeder loan was made, then no such fraud could ever possibly be satisfactorily proven. The résumé above of the circumstantial evidence and the Cashier's own admissions show that the jury could have found, and we believe would have found, if correctly instructed, that the Cashier did have knowledge in his individual capacity of these frauds. All the knowledge which Vice-President and Director Reutlinger and Director Reisch and Cashier Reutlinger had was "acquired in the course of business of the bank transacted by such officer and director" in the bank. They got, so far as the proof shows, no knowledge outside of the bank or when they were transacting any business except that of the bank itself. After reading the bill of exceptions, showing the direct testimony of Director Reisch and the admissions of Vice-President Reutlinger and Cashier Reutlinger, we are at a loss to understand how this could be said in the opinion of the Circuit Court of Appeals:

> "The testimony shows no such knowledge of McKnight's conduct acquired in the bank's business by the individual directors or officers of the bank and unknown to the Board, as would entitle the Company to notice."

If we were entitled to notice at all of any of these fraudulent and disgraceful proceedings connected with the Edmunds check for the purchase of four councilmen and the Britt and Reeder loan

for the purchase of two aldermen, then undoubtedly the knowledge of these transactions had by Cashier Reutlinger and Vice-President and Director Reutlinger and Director Reisch was undoubtedly acquired in the Bank's business, and, according to the Receiver's testimony, that knowledge was never directly communicated to the Board as a board. Surely the highest court in our land ought to avail itself of a chance to say whether such reprehensible and disgraceful conduct on the part of the President of a bank, as occurred in this bank, can go on unchecked and unreported by the officers and directors of a bank, and yet there be no duty on the part of the bank to the surety who guaranteed the faithful conduct of the President, and who would be entitled to notice of any conduct of his in connection with the bank that would be likely to inflict a heavy loss upon his surety. We have shown that Director Reisch by performing his duty as director in looking into the affairs of the bank, in the bank building itself, learned, whether from the Vice President or not is immaterial, of the corrupt political deal between McKnight and Britt and Reeder, whereby the bank's $2,000.00 was lent without interest for a year to two insolvent city politicians; and yet The Circuit Court of Appeals in its opinion quotes with approval this language from Boone on the Law of Banking, Section 132:

> "A notice to one or more of the directors when engaged in the business of the bank will be deemed notice to the bank."

If that be sound law, why did the Bank or the Board of Directors not have notice (quoting the identical language of Reisch from the Bill of Exceptions) that "the bank was open about six o'clock that night and Britt and Reeder and *the whole gang* there; he gave a note and got $2,000.00 out of the bank;" that "it was for the Council race, the Todd race, something like that;" "that the money was used for the Mayor's race, for the Todd race."

Can it be that the surety under this bond was not entitled to notice of such outrageous corruption as that, when the Bank

knew it, because Director Reisch knew it, to say nothing of Vice-President Reutlinger and the Cashier? Here (to use the language of this Court in American Surety Company v. Pauley, 170 U. S. 147) was "not simply a suspicion of the existence of such facts as would justify a careful and prudent man in charging another with fraud or dishonesty;" on the contrary, here was knowledge of such political corruption with the funds of the Bank as would justify any careful and prudent man, any honest man, in charging the President with fraud and dishonesty. If the Bank could allow its President to go on in such conduct without notice to a surety, who could afford to be a surety on his bond? There can be no dispute of the fact that Vice-President Reutlinger, as well as Reisch, knew that the Bank, at McKnight's request, was kept open until 6:30 P. M. to lend $2,000.00 of the Bank's money, without interest for a year, to two members of the Board of Aldermen, before whom McKnight had been a candidate for Mayor a few days before, and that those men had no property and gave no surety. This much, at least, was discovered by Vice-President Reutlinger and reported to the Board of Directors in formal session. When the Board went that far under these suspicious circumstances, it was the duty of the Board to probe the matter to the bottom. As this Court said in Martin v. Webb, 110 U. S. 7, 15, in speaking of the diligence which directors must exercise:

> "That which they ought, by proper diligence, to have known as to the general course of business in the bank, they may be presumed to have known in any contest between the corporation and those who are justified by the circumstances in dealing with its officers upon the basis of that course of business."

In Clerk's Savings Bank v. Thaw, etc., 2 Mo. App. 367, one director was told for whose benefit a certain note in controversy was discounted, and this director (like Director Reisch) was present in the board as a director when the note was offered for discount and received by the bank. The court said:

"We think this evidence quite competent, as tending to show notice to the bank that the paper was made for the accomodation of Morse & Co., and not of the Sectional Dock Company, and putting them on inquiry as to Drew's power and authority to make or endorse paper in the name of the Dock for any such purpose."

In the case of the National Bank of Asheville v. Fidelity and Casualty Company, 89 Fed. Rep. 819 (1898), it was held that the knowledge of the president of the dishonesty and flight of the cashier, before the bond was renewed, bound the bank and made the bond voidable. The court held:

"While under a bond insuring the fidelity of an employe, which requires the employer to make disclosure of any dishonesty of the employe known to him, the employer is not bound to use diligence to discover such dishonesty, yet where in the exercise of ordinary and reasonable care and prudence in giving attention to facts known to him, he could not have failed to draw the inference that the employe was a defaulter, he may properly be charged with knowledge of such fact."

To the same effect is Thompson on Corporations, Sec. 5224. Union Bank v. Campbell, 4 Humphrey, 394. Bank of Pittsburg v. Whitehead, 10 Watts, 397; 36 Am. Dec. 186. Smith v. South Royalton Bank, 32 Ver. 341; 76 Am. Dec. 179. City Bank of Columbus v. Philips, 22 Mo. 85; 64 Am. Dec. 254.

We have here a case like that of Graves v. The Lebanon National Bank, 10 Bush (Ky.) 23, in which Judge Lindsay said:

"There is no principle of law more settled than that persons proposing to become sureties to a corporation for the good conduct and fidelity of an officer to whose custody its money and other valuables are to be intrusted, have a right to be treated with perfect good faith. . . . We have, therefore, a case in which the directory of the bank held out to others as a trustworthy officer a man who had been guilty of repeated embezzlements and frauds, all of which might have been discovered by the exercise of slight diligence."

In Morse on Banks and Banking, Sec. 134, it is said:

"The general rule actually adopted is as follows: If the director acquired it (knowledge) in his official capacity,

or in the course of or in relation to any special matter or function of which he had charge as an agent of the bank, then he knows it as a director, and the law holds that the bank also knows it. . . . Whatever knowledge a director acquires within the scope of his official employment he is bound to communicate to his co-directors, that is to say, to the bank itself. If he neglects to do so, the bank is liable for the neglect of its agent to perform the duty of his agency. By either road the same conclusion is arrived at, which is the liability of the bank to the same extent as if it had known what its director knew and ought to have communicated." Sec. 133: "What the directors ought to have known by proper diligence as the general course of the course of the bank's business they are presumed to have known in a contest between the bank and third persons dealing with it in good faith."

Not only in this case have we the direct and unqualified admission of Director Reisch that he knew how corruptly the $2,000.00 had been lent to Britt and Reeder for a year without interest, but we have also strong circumstancial evidence to show that the vice-president and other directors and the cashier knew of McKnight's defaults.

In Tolbridge v. Betsworth, 30 Conn. 380, it was held that, as a general rule, what the directors of a corporation know regarding matters affecting the interests of the corporation the corporation will be held to know, and *knowledge on the part of the directors may be inferred from circumstances*, and it is not always necessary to show it by direct proof.

In the case of the Conn. Mutual Life Insurance Company v. Scott, 81 Ky. 540, the court exonerated a surety because the Insurance Company had not notified the surety of its agent that the agent had been in default and had taken his son into partnership with him. The court said:

"A brief recitation of them (the facts shown by circumstantial evidence) will be sufficient argument to show that the appellant knew, or ought to have known, of the existence of the partnership, and actually acquiesced in its conduct of the business of the agency. . . . And it will not be allowed to draw a distinction between the knowledge of its president and other officers who transact the daily business

of the company, and knowledge received by its board of directors in official session, for the purpose of escaping the effect of such a knowledge. There are two good reasons for disallowing such a distinction in a case like this—first, because information coming to the officers elected by the board, and entrusted with the daily transactions of the business of the company and those who deal with it, and which is necessary or naturally connected with its performance, and which such officers are in duty bound to disclose to the board, must be treated as the information of the board and binding upon it; second, because if this were not so, all advantages would be given the company in admitting or denying the information, which might never find it way to the board in official session or in its technically official capacity, although its president and other officials might possess the information and be the only channel through which it could ordinarily be communicated to the board."

But this question also is conclusively settled by the decision of this court in Guarantee Company of North America v. The Mechanics Savings Bank and Trust Company, decided January 6, 1902. In that case, as in this, the information of the teller's speculations was received first by the cashier from Kyle and an anonymous letter; then the cashier told the president, and finally he and two of the directors (not at a meeting of the board) asked Schardt about his speculations and he denied it. This information was held to bind the bank and release the surety. In our case, the knowledge of Cashier Reutlinger and of Vice-President and Director Reutlinger and Director Reisch must be held to bind the bank to the same extent and to release the surety.

In the Guarantee Company's case the officers and directors said they were deceived by their confidence in Schardt; that they were not acting in bad faith; and the same flimsy excuse is made in our case. But, in the other case, it was said by this Court that such an excuse could not relieve the officers and directors of the consequences of their neglect at the expense of the surety; and the same answer must be given here.

SEVENTH POINT.

The negligence of the Directors was a failure to use "due and customary supervision," and released the Surety.

My *seventh point* is that the Court erred in telling the jury in the Eighth Instruction (Rec. 62) that the carelessness of the directors in the management of the bank was not an issue for them to consider. The jury had been unable to agree the first day, and on the second day asked a question of the Court in writing, and the answer of the Court, we contend, was misleading, and thus brought about a verdict which otherwise would not have been rendered for the plaintiff. The jury asked the Court in writing the following question: "If the jury agree that the directors of the Bank were careless in the management of the Bank, are the jury to find for the defendant?" The jury were evidently considering that, under the contract of the Bank with the Surety Company, it was the duty of the directors to observe "due and customary supervision over the employe for the prevention of default," and that "if the employe should at any time during the currency of this bond condone any act or default on the part of the employe which would give the employer the right to claim hereunder, and should continue the employe in its service without written notification to the Company, the Company shall not be responsible, etc." To this question of the jury the Court replied (Rec. 62) as follows:

> "Gentlemen of the jury, no such issue as that stated in this question was presented. The mere question of whether or not the directors generally were careless in their management of the bank is not a question for your consideration, nor would it exempt the defendant from the obligation imposed by the bond sued on. You have already been instructed as to the meaning and effect of the condition of the bond as to due and customary supervision, and outside of that there is no provision as to carelessness."

It is evident that the jury did not believe that the directors had exercised proper supervision over McKnight. It is evi-

dent that the jury believed that the directors either knew of his defaults or could have known of them by slight care, and, therefore, the jury evidently wished to find for the defendant, if they could do so on that ground. The Court had told them that the surety was not released unless the board had specific, formal notice brought to it of McKnight's defaults. In the nature of things, we could make no such proof; but the jury evidently thought that several of the directors, as well as the cashier, knew of his defaults, and that all of the directors or the Board itself would have known of his defaults if they had not been "careless in the management of the bank."

The Supreme Court said in Martin v. Webb, 110 U.S. 15:

"Directors can not, in justice to those who deal with the bank, shut their eyes as to what is going on around them. It is their duty to use ordinary diligence in ascertaining the condition of its business, and to exercise reasonable control and supervision of its officers. . . . That which they ought, by proper diligence, to have known as to the general course of business in the bank, they may be presumed to have known in any contest between the corporation and those who are justified by the circumstances in dealing with its officers upon the basis of that course of business."

Briggs v. Spalding, 141 U. S. 132.

In Marshall v. Farmers M. S. Bank of Am., 85 Va. 673; 17 Am. St. Rep. 84, the directors of a bank, for their negligence and carelessness, were held personally liable to the creditors of the bank. After reciting this negligence, the court said:

"Ignorance on the part of directors of a bank of any fact which it is their duty to know can never be set up by them in defense or exculpation for any act which the existence of that fact should have prohibited. . . . Directors, as trustees of a corporation, are bound to manage the affairs of the company with the same degree of care and diligence which is generally exercised by business men in the management of their own affairs. . . . It is difficult to concede that they could have been ignorant of all this. But suppose they were. Their duty required that they should have looked well into all these matters; and if they have negligently trusted them to others, and loss has occurred, should it fall on them or upon the depositors who had trusted them, and whose trust they had accepted, and to whom they had solmnly promised such care and attention as were to be expected of good business men?"

In the United So. of Shakers v. Underwood, 9 Bush, 609, 621, it was held that directors of a bank are personally liable for their carelessness or neglect. Judge Lindsay said:

"It is the duty of the bank directors to use ordinary diligence to acquaint themselves with the business of the bank, and whatever information might be acquired by ordinary attention of their duties, they may, in controversies with persons transacting business with the bank, be presumed to have. They can not be heard to say that they were not apprised of facts shown to exist by the ledgers, books, accounts, correspondence, reconcilements, and statements of the bank, and which would have come to their knowledge except for their gross neglect or inattention.

"It is not necessary in many cases to show directly that the directors had their attention called to the mismanagement of the affairs of the bank, or the misconduct of the subordinate officers. It is sufficient to show that the evidences of mismanagement or misconduct were such that it must have been brought to their knowledge unless they were grossly negligent or willfully careless in the discharge of their duties. If it shall turn out upon the trial of these actions that the ledgers, books, etc., of the bank showed that the special deposits of these appellees were being sold, and that this fact would have been discovered by appellees by the use of ordinary diligence, then the presumption of actual knowledge will arise. It follows, therefore, that the allegation of notice is sufficient."

In People v. Jansen, 7 Johns. 331, the sureties on a bond were released because of the neglect or carelessness of the officers of the State in exercising proper supervision over the officer in default.

The court said:

"The statute makes it the duty of the supervisors to annually meet and inspect the accounts of the loan office. The security had a right to look to the provisions of the statute and calculate his liability on the presumption that the duties enjoined upon these public officers would be faithfully and punctually discharged, and if so, he could in no event be liable for more than one year's deficiency. There can be no douht plaintiffs are chargeable with the consequence of the neglect or breach of duty of their agents or public officers intrusted with the business."

The directors of the German National Bank, under their agreement to exercise care and supervision to protect us from

McKnight's defaults, could not shut their eyes, lay down the bars, encourage or connive at his wrongdoing, and then ask us to pay their losses so negligently or willfully incurred. *Volenti non fit injuria.*

In the Board of Education v. The Citizens Insurance Company, 30 U. C. C. P. (Canada) 132 (see Note 19 C. C. A. 276), the guaranty proposal contained certain statements which were made to form a part of the contract, one of which was that the employe's books should be balanced and closed at the end of each year, and that the cash and securities to plaintiff's credit at each balancing time would be examined and verified by the auditors, as required by the statute. There was, in fact, no audit. It was held that the terms of the contract had not been complied with, and there could be no recovery.

In the case of the Harbor Commissioners v. The Guarantee Company of North America, 22 Can. Sup. Ct. 542 (see Note 19, C. C. A. 276), the policy was granted upon the express conditions that (1) the answers contained in the application embodied a true statement of the manner in which the business was conducted and the accounts kept, and that they would be kept; (2) that the employers would give notice to the surety company immediately upon its becoming known to them of any default or dishonesty on the part of the employe. The employe defaulted, and evidence showed that no proper supervision had been exercised over his books; and, further, the grantors were not notified until a week after the employers had full knowledge of the state of affairs and the employe had left the country. It was held that there could be no recovery under the policy.

In the case of Phillips v. Foxall, L. R. 7 Q. B. Div. 666, it was said:

> "We think that in the case of a continuing guaranty for the honesty of a servant, if the master discovers that the servant has been guilty of acts of dishonesty in the course of the service to which the guaranty relates, and if, instead of dismissing the servant, as he may do at once and without notice, he chooses to continue in his employ a dis-

> honest servant, without the knowledge and consent of the surety, express or implied, he can not afterward have recourse to the surety to make good any loss which may arise from the dishonesty of the servant during the subsequent service."

The directors are the agents of the bank, and are selected by the stockholders for its management; and the corporation ought to be responsible for the derelictions of the directors. If the directors, for several years, utterly ignore their duties and allow the bank to be defrauded when ordinary care on their part would prevent such effect, the corporation, as against a surety, ought not to be relieved of the natural results of their neglect. It is true the surety here has bound itself for the fidelity of the President, but that was upon the express contract of the Bank that its Board of Directors would exercise "due and customary supervision" over the President to prevent any default. Where there is no such contract on the part of the bank it may be that the surety should not be released by the failure of the board to do its duty; but, under such an express contract, the failure of the board to do its duty ought to be and is a good defense on the part of the surety.

We respectfully but earnestly insist, especially in view of the decision of this Court in the case of the Guarantee Company of North America v. The Mechanics Savings Bank and Trust Company, that we have not had a fair trial in this case and that it should be reversed. The Circuit Court of Appeals, that heard both these cases, decided twice by a unanimous vote against the Guarantee Company, but affirmed this case by a divided court; and it is plain that the facts call more loudly for the exoneration of the surety in this case than in the other.

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